United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

76 7476

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

NEWBURGER, LOEB & CO., INC. as Assignee of Claims of David Buckley and Mary Buckley,

Plaintiff-Appellant-Cross-Appellees,

against

CHARLES GROSS, MABEL BLEICH, GROSS & CO., and JEANNE DONOGHUE,

Defendants-Appellees-Cross-Appellants,

and

NEWBURGER, LOEB & CO., a New York Limited Partnership, ANDREW M. NEWBURGER, ROBERT L. NEWBURGER, RICHARD D. STERN, as Executors of the Estate of Leo Stern, ROBERT L. STERN, RICHARD D. STERN, JOHN F. SETTEL, HAROLD J. RICHARDS, SANFORD ROGGENBURG, HARRY B. FRANK and JEROME TARNOFF, as Executors of the Estate of Ned D. Frank, FRED KAYNE, ROBERT MUH, PAUL RISHER, CHARLES SLOANE, ROBERT S. PERSKY, FINLEY, KUMBLE, WAGNER, HEINE, UNDERBERG & GRUTMAN, a Partnership, (formerly known as Finley, Kumble, Underberg, Persky & Roth and Finley, Kumble, Heine, Underberg & Grutman) and LAWRENCE J. BERKOWITZ,

Additional Defendants on Counterclaims-Appellants-Cross-Appellees.

Appeal from a Judgment of the United States District Court for the Southern District of New York

BRIEF OF APPELLANT FINLEY, KUMBLE, WAGNER, HEINE, UNDERBERG & GRUTMAN

PAUL, WEISS, RIFKIND, WHARTON & GARRISON
345 Park Avenue
New York, New York 10022
(212) 644-8000

Of Counsel:
Simon H. Rifkind
Mark H. Alcott
John M. Delehanty
Beryl A. Schatz

and

FINLEY, KUMBLE, WAGNER, HEINE & UNDERBERG
425 Park Avenue
New York, New York 10022
(212) 371-5900

Of Counsel:
Alan M. Gelb

Attorneys for Additional Defendant on Counterclaims-Appellant-Cross-Appellee Finley, Kumble, Wagner, Heine Underberg & Grutman

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BRIEF OF APPELLANT FINLEY, KUMBLE, WAGNER, HEINE, UNDERBERG & GRUTMAN

Preliminary Statement

This is an appeal by Finley, Kumble, Wagner, Heine, Underberg & Grutman ("Finley, Kumble"), a law firm, from a judgment of the United States District Court for the Southern District of New York (Honorable Richard Owen, J.) entered on September 1, 1976 after trial by the Court sitting without a jury.

The judgment below imposed unprecedented liability upon a law firm for its vigorous representation of a financially troubled client. The District Court held Finley, Kumble liable in damages to defendants in the amount of $675,830; interest and costs bring the full amount of the judgment to almost $1 million. This large and punitive award rests solely on legal services which Finley, Kumble rendered in connection with the reorganization of the Newburger, Loeb Partnership into a newly formed Corporation and the transfer of the Partnership's assets to the Corporation. It is undisputed that Finley, Kumble acted only as counsel, not as a principal, in this transaction; it had no interest other than to assure that its client was assiduously represented. The District Court's imposition of liability upon Finley, Kumble in these circumstances was error.

The District Court based its decision on the holding that Finley, Kumble and the other parties who sought to rescue Newburger, Loeb had engaged in a common law "conspiracy" to injure defendants. There is no tort of "conspiracy" under

New York law. Moreover, none of the specific actions found by the Court to have been taken by Finley, Kumble constitutes an actionable wrong.

The District Court did not have subject matter jurisdiction over the common law counterclaims upon which it based liability upon Finley, Kumble. These claims were totally unrelated to the federal securities claims set forth in the complaint; thus, they were not "compulsory counterclaims" within the Court's "ancillary jurisdiction," and their dismissal was mandatory.

Finally, the District Court's assessment of damages was erroneous. Among other things, the District Court imposed punitive damages of $50,000 although such damages were impermissible under the governing law; granted affirmative relief upon a counterclaim which the Court had expressly held to be available only as a set-off; failed to permit the accounting which the Court implicitly recognized to be necessary; and awarded damages to defendant Charles Gross in an amount unjustified by the law or the facts.

Issues Presented

The issues presented on this appeal are:

1. Did the District Court err in asserting jurisdiction over defendants' non-federal First, Second and Fourth Counterclaims?

2. Did the District Court err in holding that Finley, Kumble's actions constituted an actionable "conspiracy" against defendants?

3. Did the District Court err in imposing liability upon Finley, Kumble for actions it performed solely as counsel and not as a principal?

4. Did the District Court err in its assessment of damages against Finley, Kumble by, among other things:

(a) awarding punitive damages of $50,000;

(b) awarding damages of $134,171, plus interest, to Gross for the "conversion" of certain of his securities when the counterclaim alleging such conversion was available only as a set-off; and

(c) awarding damages of $337,921, plus interest, to Gross representing his capital interest in the Partnership when it failed to permit the accounting which it implicitly recognized as necessary and based its award upon inconsistent and erroneous proof?

The Facts

A. Newburger, Loeb's Financial Crisis

This action arises out of the severe economic woes which afflicted the Wall Street brokerage firm of Newburger, Loeb & Co. (the "Partnership") during the "back office crunch" in the stock market in 1970. Finley, Kumble was

retained as special counsel by the Partnership with respect to a real estate matter in the autumn of 1970 (A1078-79).* Thereafter, its legal representation gradually broadened (*Id.*) Robert Persky, then a member of Finley, Kumble, was one of the law partners in charge. At the time Finley, Kumble was retained, and for a substantial period before then, the Partnership was in desperate financial straits (A4457; A3411; A3414).

The gravity of the Partnership's financial situation increased shortly after Finley, Kumble was retained. Several limited partners and subordinated lenders notified the Partnership that they intended to withdraw their capital (A2752-54; E1). Consequently, on November 17, 1970, the New York Stock Exchange advised the Partnership in writing that it would suspend the Partnership from the Stock Exchange unless its impaired capital condition was immediately corrected. The Stock Exchange's letter stated, in pertinent part, as follows:

> "[I]n view of your impaired capital position and loss trend, this Department [Department of Member Firms] is left with no alternative but to approach the Board of Governors and ask for your suspension * * * if your 'REQUIRED EXCESS CAPITAL' is not met by the close of business on November 20, 1970. A signed merger agreement filed with this

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* The Appendix is divided into three sections. Those pages preceded by the designation "A" refer to the trial transcript. Those pages preceded by the designation "E" refer to the Exhibit Volumes. Those pages without a prefix refer to the other parts of the record such as pleadings, and the District Court's opinion.

> Department by the close of business on November 20, 1970, will be acceptable in lieu of the REQUIRED EXCESS CAPITAL.
>
> "In the meantime, you are directed to take every possible anticipatory step to prepare for possible liquidation of your firm, such as discontinuing any purchases of your firm trading and investment accounts, liquidating proprietary positions, and other administrative procedures in the event of a suspension by the Board of Governors." (E1).

Throughout the period relevant to this action, the Partnership was threatened with this imminent suspension -- which, if carried out, would have caused its demise.

B. The Proposed Reorganization

The most significant step taken by the Partnership to solve its financial problems was the proposed reorganization of the Partnership into a new Corporation which would be accompanied by the infusion of new capital. Under this proposal, the Partnership would transfer its assets to the Corporation pursuant to a Transfer Agreement. This proposal emerged from discussions between financial consultants Paul Risher and Robert Muh and independent counsel for the Partnership's limited partners (A2766-67; A3267-68; E240). The prime reason for the proposed reorganization was that efforts to attract new capital into the Partnership had failed (A3266-67).

When it became apparent that this proposed reorganization was the only alternative to suspension of the firm, separate counsel were retained by the Partnership and the

proposed Corporation (A3933-34). Rosenman, Colin, Kaye, Petschek, Freund & Emil was retained to represent the Partnership; Finley, Kumble was retained to represent the proposed Corporation and its promoters (A3934). Finley, Kumble's function was to draft documents in connection with the proposed reorganization and to assist in the negotiations concerning it. Robert Persky also introduced the promoters to a potential lender, Alex Aixala, who ultimately loaned the new Corporation $1 million (517).

C. The Gross Faction

As so often happens in business negotiations involving many people with diverse financial interests at a time of great economic stress, there was one holdout to the proposed reorganization. Here it was Charles Gross. Gross had had his own brokerage firm, Gross & Co., which had cleared its transactions with the Partnership (36; A2297). His partners included his secretary Mabel Bleich and his sister Jeanne Donoghue. In 1969, Gross joined Newburger, Loeb as a general partner and became managing partner. He brought Bleich and Donoghue with him as limited partners (Id.).

Gross's management of the firm was a failure; the Partnership continued to lose money and was bogged down in costly and time consuming paperwork (A3414; A3419-20). As a result, at the suggestion of other general partners, Gross resigned as managing partner and withdrew from the firm effective

September 30, 1970, becoming a "withdrawn general partner." Under the terms of the Partnership Agreement, Gross no longer had a voice in the firm's operations, but his capital remained at risk for one year after he left (A2472). After Gross left, Bleich and Donoghue remained as limited partners for a few months, but gave notices of withdrawal on December 31, 1970, effective June 30, 1971 (E691; E692). (Gross, Bleich and Donoghue are collectively referred to herein as the "Gross faction.")

Gross did not object to the terms of the proposed reorganization *per se*; he was unhappy with the terms as they related to him. Under the plan negotiated among the general partners, limited partners and subordinated lenders of the Partnership, each of these conflicting groups would receive securities in the new Corporation rather than cash (E38). The amount of securities allocated to a general partner would be based upon his capital account. Instead of participating on the same basis as everyone else, Gross sought special treatment; he wanted to receive cash rather than securities in the new Corporation, and he also disputed the computation of his capital account (A2344; E871). In order to obtain this advantage over the other participants, Gross sought to block the reorganization.

However, Gross had no legal right to object to the reorganization. It is undisputed that, since Gross had withdrawn from the Partnership, his consent was not required for the proposed reorganization; indeed, Gross admitted that he had

no voice in Partnership affairs (453; A2472). However, he effectively controlled the votes of Bleich and Donoghue (A1174; A1752; A4290) and contended that the reorganization would be void without their consents. Thus, Gross sought to block the reorganization through them. When the reorganization was originally formulated, Arthur Silverman, Bleich and Donoghue's attorney, said that the plan was in his clients' best interests and recommended consent to it (E154). Bleich and Donoghue gave their consent (A1645-46). However, thereafter they withdrew their consent when Gross continued his opposition to the plan (E715; E726).

D. <u>The Efforts to Reach a Compromise with the Gross Faction</u>

In December, 1970, January, 1971 and early February, 1971, the parties who favored the reorganization held a series of meetings with the Gross faction in an effort to resolve the objections to the proposed reorganization and to reach a compromise.

As so often happens at such meetings, the parties, in the course of hard bargaining, stated that they would assert various claims against each other if the matter were not settled. Finley, Kumble was one of the many counsel who participated in such negotiations. All of the actions taken by Finley, Kumble at these meetings were designed to reach an accommodation with Gross -- a goal desired by Finley, Kumble's client as well as by all other parties to the proposed transfer, including Gross (A4287-88).

For example, at one of the negotiating sessions, Gross's attorney, Philip Mandel stated that Gross preferred liquidation of the Partnership to the proposed reorganization (A1244-54). Robert Persky attempted to reason with Mandel by pointing out that no assets would be available to pay Gross anything if the Partnership were liquidated (A1252-54).

Other efforts were also made to persuade Gross to reach a compromise. At another negotiating meeting, Robert Persky exhibited to Gross's attorney a proposed complaint against the Gross faction for damages based on their churning of the brokerage accounts of their former customers, David and Mary Buckley (A1173; A1738-41; E457).

The Buckley churning claim arose under the following circumstances: In June, 1970, before Finley, Kumble had become counsel, the Partnership had commenced an arbitration against the Buckleys to recover the substantial amounts due on the Buckleys' accounts with the Partnership (A898-99; E101). The Buckleys, represented by the well-known firm of Webster Sheffield Fleischmann Hitchcock & Brookfield (A371; A381-82), interposed a defense and counterclaim that their accounts had been churned during the period 1962-1966 (E110). During the period of the alleged churning, Gross & Co handled the Buckleys' accounts; however, since Gross & Co. cleared its transactions with the Partnership, the Buckleys were also considered to be accounts of the Partnership (E3-4).

In the autumn of 1970, Lawrence Berkowitz, the Partner-

ship's house counsel, reviewed the Buckley file as well as all litigation files to which the Partnership was a party "with a view to settling or pursuing claims as vigorously as possible in order to raise as much cash as we could, as quickly as we could" (A907). After reviewing the Buckley file, Berkowitz concluded that Gross & Co., the originating brokerage house, and not the Partnership, was responsible for the alleged churning (A902). Berkowitz conveyed this opinion to Robert Persky of Finley, Kumble, who then proceeded to negotiate a settlement of the Buckley matter in which the Buckleys paid $50,000 to the Partnership and assigned to the Partnership their claims against Gross & Co. (A903-06). Berkowitz obtained authority from the Partnership for the proposed settlement and authorized Persky to bring about its consummation (A905-06; E943).

Aside from the churning claim, Persky, as counsel, also sought to marshal the other claims which had been asserted against Gross during the negotiations. Since many of the partners were verbalizing claims against Gross, Persky asked Ned Frank, one of the more vociferous of Gross's opponents in the Partnership and who had been a practicing attorney, to put all of the claims in writing (A1360-61). Some of the claims in this "Ned Frank list" were asserted by the Corporation in its reply in this action (A1450); the claims were described in detail in an affidavit by Mr. Frank in opposition to Gross's unsuccessful pre-trial motion for summary judgment (163-192).

The final negotiating session was held on February 8,

1971 (A1940-43; A4291-93). Gross's attorney stated that Gross wanted \$100,000 cash - \$75,000 for Donoghue and \$25,000 for himself, plus securities for the remainder of his capital account (A1941-43; A4292; E994). Persky responded that Risher, Muh and Kayne personally would pay \$25,000 to Gross. But Newborg, one of the subordinated lenders, and Robert Steefel, one of the attorneys for the limited partners, objected to giving in to Gross's demands for special treatment and thus no settlement was reached (E994).

Persky and Finley, Kumble were not alone in their efforts to reach a compromise with Gross. Other counsel and parties who favored the reorganization joined in these efforts (A721; A1851; A1869; E672). Indeed, most of the claims asserted against Gross were voiced by persons other than Finley, Kumble (A4287-89). For example, one of the California partners of the Partnership, Charles Sloane, called Gross and told him that he and Fred Kayne, another California partner, were planning to commence an action against him for inducing them to become partners by misrepresenting the Partnership's financial condition (A3495-97; A3517-19). Kayne and Sloane asked independent California counsel to bring the action; it was filed in California on February 3, 1971. Finley, Kumble had nothing to do with the institution of that action (A3495-97; A3517-19).

The critical and undisputed point about the negotiations with Gross is that they were a complete failure. None of the arguments, blandishments, not even what the District Court found to be "threats," had the slightest effect on Gross. He

continued to withhold the consents of Bleich and Donoghue.

Meanwhile, the need for the reorganization had become acute. The New York Stock Exchange had increased its pressure on the Partnership to go forward with the reorganization and set a deadline of February 12, 1971, for resolution of the Partnership's financial problems. If the Transfer Agreement had not been executed on February 11, 1971, the Stock Exchange would have suspended the Partnership the following day (522-23; A1128). As a result, the parties favoring the proposed reorganization decided to go forward with the closing without the consent of the Gross faction. The attorneys for the Gross faction, Mandel and Silverman, were on the counsel distribution list and were aware of the date of the closing (E155); nevertheless, they chose not to attend (A1181).*

E. <u>The Closing and the Opinion Letter</u>

The closing took place at Finley, Kumble's offices on February 11, 1971, the last day before the New York Stock Exchange's threatened suspension. Between fifteen and twenty distinguished counsel were present (A4294); Willkie, Farr & Gallagher represented some of the subordinated lenders (A637; A639-40); Stroock & Stroock & Lavan and Richenthal, Abrams & Moss represented some of the limited partners (A728; A4281; A4293); Finley, Kumble represented the Corporation (A1126); and Rosenman, Colin, Kaye, Petschek, Freund & Emil acted as special counsel to the

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* Indeed, Mandel threatened to apply for a temporary restraining order against the closing, but then failed to do so (E1037).

Partnership and counsel for certain general partners (A730; A1639; A2353).

One of the many documents which was supposed to be presented at the closing was an opinion on behalf of the Partnership relating to its authority to enter into the Transfer Agreement. Under paragraph 6 of the Transfer Agreement, the opinion letter was one of the conditions precedent to the Corporation's obligations to execute the Transfer Agreement (E38; E43-44). Thus, the opinion letter was for the benefit of the Corporation and could have been waived by it.

Paul Burak, of the Rosenman firm, representing the Partnership, announced at the closing that his firm would not give the opinion (A4293-94).* During the weeks immediately preceding the closing, when Burak and Finley, Kumble were exchanging drafts of documents and schedules to be attached to the Transfer Agreement, Burak had advised Michael Bamberger at Finley, Kumble that his firm was having a "problem" with the opinion letter (A2158). The problem was whether, under § 98 of the New York Partnership Law and all of the other factors present, the signatures of Bleich and Donoghue were required.

When Burak advised Bamberger that the Rosenman firm was having a "problem" with the opinion, Bamberger assigned an associate at Finley, Kumble to research the question (A1128; A3890-91). Thus, at the closing, when Burak said that his firm

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* However, Robert Steefel testified that in the days prior to the closing, Max Freund of the Rosenman firm had told him they would be giving the opinion (A731-33).

would not give the opinion, a question arose as to whether any other attorney present could do so (A4294). In response, Persky said that Finley, Kumble had had some research done on the question and that he believed, based on his background and the research, that he could give such an opinion if there was no objection (A4295). It was agreed among all present that, while Finley, Kumble represented the proposed Corporation and its promoters, it could give an opinion for the Partnership if everyone consented (A4295).

The opinion letter prepared by Persky pointed out all of the circumstances leading up to the reorganization, including the New York Stock Exchange's threat of suspension, and described the relevant provisions of the Partnership Agreement. It concluded that, although the question of whether § 98 of the New York Partnership Law required the consents of Bleich and Donoghue was not free from doubt, under the exigencies faced by the Partnership, such consents were not necessary (E135-36).

The opinion letter was examined and approved by all of the attorneys present (A738; A4295). All general partners, limited partners (except Bleich and Donoghue) and subordinated lenders executed the Transfer Agreement without any objection (A4295-96). All of such parties, including general partners with greater capital accounts than Gross, and subordinated lenders who had priority over all others in receiving repayment of their loans, agreed to accept non-

cash interests in and obligations from the Corporation (A1917-18; E38).

Nature of the Case and Pre-Trial Proceedings

The Corporation commenced this action on February 16, 1971, as assignee of the Buckleys. The complaint alleged that, from April 1962 through August, 1966, the Gross faction had wrongfully induced and failed to supervise excessive trading in the Buckleys' brokerage accounts (commonly called "churning") in violation of the federal securities laws (2-9).

In their amended answer and counterclaims the Gross faction* asserted nine counterclaims against not only the Corporation but also against 19 strangers to the original action which it brought into the case as "additional defendants on counterclaims," including Finley, Kumble and Robert Persky.** In their original answer and counterclaims filed in May, 1971, the Gross faction did not name Finley, Kumble as a counterclaim defendant (11). Finley, Kumble was brought into this action as an alter-

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* In their responsive pleadings, the Gross faction unilaterally added Jeanne Donoghue as a party to the Gross faction's counterclaims without obtaining permission from the District Court.

** In addition to Finley, Kumble and Persky, the following third parties were named as "counterclaim defendants": the Partnership; various partners therein, including Andrew M. Newburger, Robert L. Newburger, Leo Stern, Walter D. Stern, Robert L. Stern, Richard D. Stern, John F. Settel, Harold J. Richards, Sanford Roggenberg, Ned D. Frank, Fred Kayne, and Charles Sloane; the promoters and thereafter principal officers of the Corporation, Robert Muh and Paul Risher; Lawrence J. Berkowitz, former house counsel to the Partnership; and Alex Aixala, a large investor in the Corporation.

thought nine months later, when the Gross faction filed its amended pleading (31). The counterclaims alleged that Finley, Kumble and the other "counterclaim defendants" had engaged in various allegedly tortious acts against the Gross faction in connection with their effort to reorganize the Partnership into the newly formed Corporation.

Only four of the Gross faction's counterclaims are involved on this appeal:* The First Counterclaim, which alleged that the transfer violated the New York Limited Partnership Law; the Second Counterclaim, which alleged that the commencement of this action was wrongful because the Partnership's receipt of the assignment of the churning claims violated its fiduciary duties to the Gross faction; the Third Counterclaim, which alleged that the "counterclaim defendants" had "converted" certain of Gross's securities (referred to herein as the "Conversion Counterclaim"); and the Fourth Counterclaim, which alleged that the "counterclaim defendants" had "conspired" to injure the Gross faction by bringing about the transfer of the Partnership's assets to the Corporation over the Gross faction's opposition.

In reply to the Gross faction's counterclaims, the Corporation asserted six additional counterclaims of its own against Gross, based on the "Ned Frank" list, charging that Gross had engaged in various acts of misconduct while serving as the managing partner of the Partnership (55-74).

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* The remaining counterclaims were either not asserted against Finley, Kumble, only available as set-offs, or dismissed by the Court.

In October, 1973, in ruling on various pretrial motions by the parties, Judge Robert J. Ward held that five of the Gross faction's eight common law counterclaims (including the "Conversion Counterclaim") were jurisdictionally defective and could only be asserted as set-offs to any relief granted on the complaint (365 F. Supp. 1364, 1367 (S.D.N.Y. 1973)) (448-49). The Court held that the Gross faction's three remaining common law counterclaims (the First, Second and Fourth Counterclaims) were "compulsory" and thus within the Court's "ancillary jurisdiction."

Decision of the Trial Court

This action was tried before Judge Richard Owen, sitting without a jury, in June, July and August, 1975.* Judge Owen rendered his decision almost one year after the conclusion of the trial, in an opinion and order dated July 7, 1976 (508-37).** After briefly summarizing the evidence, the District Court denied the Corporation's churning claims. While finding that there were "a great number of transactions" in the Buckleys' accounts, the Court concluded, nevertheless, that the Buckleys had controlled their accounts and that David Buckley was motivated by a desire "to make his own name and fortune. . . by profitable speculation" (513). In light of these findings, the Court found that the churning claims had not been proved.

The Court described the Gross faction's non-federal

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* The trial began before a jury, but the jury was dismissed by consent of the parties.

** The opinion is not officially reported.

First, Second and Fourth Counterclaims to be "at the heart of this proceeding" (514). Judge Owen did not question Judge Ward's prior ruling that, because these counterclaims were "compulsory", the Court had subject matter jurisdiction over them. Judge Owen also accepted, without independently reviewing the matter, Judge Ward's ruling that the Gross faction's five other common law counterclaims were jurisdictionally defective and thus only available as set-offs (514). Nevertheless, as noted above, p. 3, Judge Owen inexplicably granted relief on one of these counterclaims.

The District Court's findings concerning the relevant counterclaims are merely a condensed narrative of the steps taken by the promoters of the new Corporation (whom the District Court refers to as the "new team") to reorganize the Partnership into a Corporation and their efforts to persuade the Gross faction to go along with the reorganization and transfer. Those efforts, in the Court's view, were tortious and subjected the counterclaim defendants to liability (526-27).

It is difficult to discern the legal theories upon which the Court based its decision. The Court did not cite a single case in support of its holding. Nor did it distinguish between those acts by counterclaim defendants which were allegedly legal wrongs and those which were merely "hard bargaining." Nor did the Court make any clear delineation of which counterclaim defendant was responsible for which steps (517-18, 526). Apparently, because of its civil conspiracy theory, the Court felt that each counterclaim

defendant was chargeable with the acts of the others.*

The Court did not specify the legal theory upon which it based its finding that Finley, Kumble was liable to the Gross faction. While it cited certain specific actions taken by Robert Persky, the Court never reconciled these acts with the fact that Finley, Kumble was acting as counsel and not as a principal. Apparently recognizing this problem, the Court strained to find some special interest on the part of Persky which would justify finding Finley, Kumble liable. Yet the only interest cited was that of "getting a new client for himself and his firm" (525).

The District Court awarded (a) damages of $134,171, plus interest, for the "conversion" of Gross's "in-kind" securities; (b) damages of $337,921, plus interest, representing Gross's capital interest; (c) damages of $153,737, plus interest, representing Bleich's and Donoghue's capital interests; and (d) punitive damages of $50,000.

As to the "conversion" of Gross's "in-kind" securities, the District Court overlooked Judge Ward's ruling that since this claim was jurisdictionally defective, there could be no affirmative relief with respect to it. Indeed, the District Court also ignored its own holding that it need not and would not consider the merits of this claim (514).

As to the Gross faction's capital interests, the Court found that Bleich and Donoghue were each entitled to $76,868,

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* The Court relied on its notes and the notes of a "courtroom observer" in reaching its conclusions; there was no transcript (511).

plus interest, and that Gross was entitled to whatever an accounting would show was owing to him on the date of the transfer, February 11, 1971 (529). However, the Court made a determination as to the amount of Gross's capital interest without having a proper accounting. Rather, the Court relied solely on the testimony of one accountant, Irving Lauterbach, whose testimony contained fundamental inconsistencies and errors (530).

Finally, the District Court found certain parties liable for punitive damages. The opinion appears to assess punitive damages against "the new team (except Berkowitz), Persky and Finley, Kumble in the sum of $50,000." The District Court originally defined the "new team" as consisting of Kayne, Muh, Risher, Sloane and Berkowitz. However, after the judgment was entered, the District Court deleted Muh and Sloane from that portion of the judgment awarding punitive damages and stated that it "did not find these people liable under that cause of action" (571).

This inconsistency is another reflection of the District Court's failure properly to differentiate which acts were attributable to which parties and, indeed, to indicate which acts constituted an actionable wrong.

I

THE DISTRICT COURT LACKED SUBJECT MATTER JURISDICTION OVER THE GROSS FACTION'S NON-FEDERAL COUNTERCLAIMS

The District Court's extension of its jurisdiction to include the non-federal claims on which its decision below rests

is unprecedented. The common law counterclaims on which the Court granted relief involved not only the parties to the original action -- the Corporation and the Gross faction -- but, in addition, 19 strangers to the original action who had nothing to do with the case in chief but were brought into federal court solely to answer to the counterclaims. Indeed, Finley, Kumble was not brought into this case until nine months after the Gross faction filed its orginal answer and counterclaims.*

The alleged justification for the Court's expansion of its jurisdiction to encompass these common law claims was the holding that these non-federal counterclaims, asserted against third parties, were "compulsory" and thus within the Court's "ancillary jurisdiction." This holding was erroneous. Since these claims were not compulsory, and since there was no independent basis for federal jurisdiction over them, the law required their dismissal.

It is undisputed that the Gross faction's First, Second and Fourth Counterclaims did not involve federal questions and there was no diversity of citizenship among the parties, most of whom were residents of New York. The law is clear that, under such circumstances, the District Court could assert jurisdiction over such counterclaims only if they were "compulsory" and thus within the Court's "ancillary jurisdiction." United States ex rel.

* An illustration of the Court's extraordinary outreach is the role of Mrs. Donoghue, who was not named as a party to the original case but who was nevertheless brought in as a plaintiff on the counterclaims. Mrs. Donoghue, who was not a defendant in the federal complaint, was permitted to enter as a volunteer and recover as a plaintiff on purely non-federal counterclaims against 19 non-federal additional defendants.

D'Agostino Excavators, Inc. v. Heyward-Robinson Co., 430 F.2d 1077, 1080-81 (2d Cir. 1970). There, this Court stated, "Under the rule in this circuit, if [counterclaims] are permissive there is no Federal jurisdiction over them unless they rest on independent jurisdictional grounds."

The District Court accepted this premise. However, it misapplied the standards which determine whether a counterclaim is "compulsory."

The basic standard is set forth in Rule 13(a), Fed. R. Civ. P., which defines a "compulsory counterclaim" as one "aris[ing] out of the transaction or occurrence that is the subject matter of the opposing party's claim. . . ." The criteria for determining whether a counterclaim is compulsory under Rule 13(a) were set forth by the Court of Appeals for the Tenth Circuit in Pipeliners Local 798 v. Ellerd, 503 F.2d 1193, 1198 (10th Cir. 1974):

> "It has been said that most courts, rather than attempting to define the key terms of Rule 13(a) . . . precisely, have preferred to suggest standards by which the compulsory or permissive nature of specific counterclaims may be determined: (1) Are the issues of fact and law raised by the claim and counterclaim largely the same? (2) Would res judicata bar a subsequent suit on defendants' claim absent a compulsory counterclaim rule? (3) Will substantially the same evidence support or refute plaintiffs' claims as well as defendants' counterclaim? and (4) Is there any logical relation between the claim and the counterclaim? See Wright and Miller, Federal Practice and Procedure, Civil § 1410, Ch. 4, p. 42 and cases cited. . . ."

These four criteria have been consistently cited with approval by courts in this Circuit and elsewhere. See, e.g., Sue & Sam Mfg. Co. v. B-L-S Constr. Co., 538 F.2d 1048 (4th Cir. 1976); Hercules Inc. v. Dynamic Export Corp., 71 F.R.D. 101 (S.D.N.Y. 1976); Agostine v. Sidcon Corp., 69 F.R.D. 437 (E.D. Pa. 1975).

None of the four criteria considered by the courts in determining whether a counterclaim is compulsory is present here. The issues of fact and law raised by the complaint and the counterclaims are entirely different; a decision on the claims in either pleading would not be res judicata in an action on the claims in the other; none of the evidence is common to the respective claims; and there is no logical connection between them.

First, the issues of fact and law raised by the complaint and the counterclaims are totally disparate. Plaintiff's claims relate to the alleged churning of the brokerage accounts of David and Mary Buckley by the Gross faction from April, 1962 through August, 1966. The issues involved are the quantity and nature of the transactions in the Buckleys' accounts during this period, whether the Buckleys exercised control over the accounts, and whether the transactions violated the federal securities laws or the common law of fraud.

On the other hand, the relevant counterclaims relate to the transfer of assets, on February 11, 1971, of the Partnership to the Corporation, and the Gross faction's opposition to that transfer. The counterclaims concern events occurring during 1970 and thereafter, four years after any transactions which are the subject of the complaint. The issues involved are whether the transfer from the Partnership to the Corporation violated state law and whether the counterclaim defendants committed torts against the Gross faction in connection with the transfer. These issues have nothing whatsoever to do with any events in 1962 through 1966,

let alone the events relating to the nature of the Buckleys' brokerage accounts.

Second, a disposition of the complaint would not be <u>res judicata</u> of the counterclaims, and vice versa. Regardless of the outcome of the Buckley churning issues raised in the complaint, the Gross faction clearly could have brought a separate suit alleging both a wrongful transfer of assets and the other tortious conduct asserted in these counterclaims. Similarly, a decision on the counterclaims would not have barred an action on the claims raised in the complaint.

Third, the evidence on the complaint and the counterclaims was completely different. The trial below was really <u>two</u> trials, one of the churning claims and the other of the Gross faction's counterclaims. The testimonial and documentary evidence introduced on the claims in the complaint was not considered on the trial of the counterclaims, and the proof on the counterclaims had no bearing on the claims in the complaint.

The principal witnesses on the Corporation's case were: the Buckleys; Robert Jordan, the "customer's man" at Gross & Co. who handled their accounts; and David Marcus, a securities law expert who analyzed the transactions in the Buckley accounts. None of these persons testified concerning the Gross faction's counterclaims. Similarly, none of the many witnesses who testified about the counterclaims gave evidence on the churning claims.

Finally, there is no "logical relation" between the complaint and the counterclaims. The only possible connections between the complaint and the counterclaims are (a) that the

very bringing of the churning claim by commencing this suit was itself tortious or (b) that the counterclaims are in some way related to a "defense" to plaintiff's claim. Neither of these "connections" constitutes the type of "logical relation" requisite for the exercise of federal jurisdiction.

First, the District Court, in ruling on this matter, did not rely on the argument that the complaint and counterclaims are logically "connected" merely because the counterclaims allege, *inter alia*, that the filing of the complaint was a tortious act. Nor could it, since it is well established that the assertion of wrongful conduct or improper motives in bringing a lawsuit is not a compulsory counterclaim to the allegedly wrongfully instituted action. The reason for this is that such a claim is not mature until the merits of the underlying action have been determined. *See*, *e.g.*, *Solomon* v. *Bruckhausen*, 305 F.2d 941, 943 (2d Cir. 1962), *cert. denied*, 371 U.S. 951 (1963); *Poloron Products, Inc.* v. *Lybrand, Ross Bros. & Montgomery*, 66 F.R.D. 610, 615 (S.D.N.Y. 1975), *rev'd on other grounds*, 534 F.2d 1012 (2d Cir. 1976); *Bach* v. *Quigan*, 5 F.R.D. 34, 36 (E.D.N.Y. 1945). *See*, *also*, 6 Wright & Miller, *Federal Practice and Procedure*: *Civil* § 1411 at 56, and cases cited thereunder.

As succinctly stated by Professor Moore:

> "[a] claim in the nature of malicious prosecution which arises out of the bringing of the main action, generally cannot be asserted either as a compulsory or a permissive counterclaim, since such a claim is premature prior to the determination of the main action." 3 Moore s Federal Practice ¶ 13.13 at 13-308 (2d ed. 1969).

In Poloron, the Southern District held, in circumstances similar to the present case, that defendant's counterclaims were permissive, and that the Court therefore lacked jurisdiction over them. The complaint alleged that defendant had violated the federal securities laws by preparing false financial statements. In its counterclaims, defendant alleged that the suit had been instituted maliciously and without probable cause, and that the plaintiff was indebted to defendant for professional services rendered. The Court dismissed both counterclaims as jurisdictionally defective:

> "Although the success of the first counterclaim for malicious prosecution depends upon the failure of plaintiff's claim, it does not 'arise' until the action has been terminated in favor of the defendant. Rosemont Enterprises Inc. v. Random House, Inc., 261 F. Supp. 691, 695 (S.D.N.Y. 1966); Slaff v. Slaff, 151 F. Supp. 124, 125-26 (S.D.N.Y. 1957); Park Bridge Corp. v. Elias, 3 F.R.D. 94 (S.D.N.Y. 1943); 3 Moore, [Federal Practice] ¶ 13.13 at 13-308 [(2d ed. 1969)]." Id. at 615.*

As for the second counterclaim, the Court held that the amounts allegedly owing for professional services did not arise out of the same transaction or occurrence as plaintiff's claim under the securities law. Id. at 615.

The second, and only remaining argument that could be urged in support of holding that these counterclaims were compulsory -- and the argument on which the District Court solely relied -- is the contention that they relate to a "defense" to the churning claim. The defense in question is that the assignment of the churning claim by the Partnership to the Corporation was invalid because

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* In reversing the District Court's application of the two-dismissal rule, this Court did not pass on the dismissal of the counterclaims. 534 F.2d 1012 (2d Cir. 1976).

it was part of the unlawful Transfer Agreement. Judge Ward, in holding that the First, Second and Fourth counterclaims were compulsory, reasoned that "[t]hey are so closely linked to defenses to the plaintiff's claim that they must be considered 'logically related to the claim the opposing party is suing on'... [and that] this conclusion is consistent with the general trend toward expansion of the concept of compulsory counterclaims" (365 F. Supp. at 1367).

However, there is no authority to support the contention that a link between a counterclaim and a defense is a sufficient nexus to support federal jurisdiction. The very language of Rule 13(a) mandates the conclusion that this is not a sufficient nexus, since the Rule defines a compulsory counterclaim as any "claim which ... arises out of the transaction or occurrence that is the subject matter <u>of the opposing party's claim</u> . . ." (Emphasis supplied). Rule 13(a) does not speak in terms of defenses.

In <u>Agostine</u> v. <u>Sidcon Corp.</u>, 69 F.R.D. 437 (E.D. Pa. 1975), the Court rejected a defendant's contention that a counterclaim was compulsory because it related to a defense. There, a borrower had brought an action against a lender and its collecting agent for violation of the Truth in Lending Act, 15 U.S.C § 1601-1681t, by failing to make proper disclosures in connection with the refinancing of certain loans. The defendant counterclaimed to recover default payments on the outstanding debt obligations. The Court rejected defendant's contention that the counterclaim was compulsory because, if plaintiff were to prevail on its claim, plaintiff would have an absolute defense in a subsequent state court action by defendant

on its claim. The Court also determined that none of the four factors set forth in the Ellerd case, supra, were present and that therefore, the counterclaims were permissive and had to be dismissed. The Court determined that the two claims were "distinct in nature; one involves a federal statute, while the other consists of state contract claims." Agostine, supra 69 F.R.D. at 442.

Judge Ward did not cite any case in which a counterclaim was held to be compulsory because it was related to a defense. Indeed, the only case cited by Judge Ward to support the assertion of jurisdiction over the three counterclaims, United States ex rel. D'Agostino Excavators, Inc. v. Heyward-Robinson Co., 430 F.2d 1077 (2d Cir. 1970), is inapposite. There a subcontractor sued to recover payments from the prime contractor and its surety for work performed on a federal job. The prime contractor counterclaimed for alleged overpayments on both the federal job and on a non-federal job. At trial, "the two subcontracts in suit were treated together," with both the subcontractor and prime contractor claiming breaches of both contracts by the other. Id. at 1079. This Court ruled that the counterclaim on the non-federal job arose out of the same transaction or occurrence as the plaintiffs' claim, and that therefore, the counterclaim was compulsory. In finding a sufficiently close relationship between the claims, this Court noted that:

> "Both subcontracts were entered into by the same parties for the same type of work and carried on during substantially the same period. Heyward [the prime contractor] had the right to terminate both subcontracts in the event of a breach by D'Agostino of either. Heyward also had the right to withhold monies due on one to apply against any damages suffered on the other. Progress payments made by

> Heyward were not allocated as between jobs and were made on a lump sum basis for both as though for a single account." Id. at 1081-82.

Moreover, this Court observed that both the claim and counterclaim "'were so interwoven at the trial that they are now absolutely in-capable of separation.' The proof as to payments and alleged defaults in payments was made without any differentiation between the two claims and neither of the parties was able to offer any evidence of apportionment." Id. at 1082.

None of the factors which were present in Heyward-Robinson are present here. The counterclaims here relate to events at a different time, among largely different parties and involving totally different factual and legal issues. And unlike Heyward-Robinson, the churning claim and counterclaims were not, and indeed could not have been, "interwoven" at trial.

There is, in short, no basis for treating the counter-claims as "compulsory" and the District Court did not have jurisdiction over them.

II

FINLEY, KUMBLE DID NOT COMMIT ANY ACTIONABLE TORTS

The District Court based its decision against Finley, Kumble upon its holding that Finley, Kumble and the other persons who sought to rescue Newburger, Loeb had engaged in a civil, common law "conspiracy" to injure the Gross faction. There is no independent tort of "conspiracy" under New York law. Moreover, none of the steps found by the District Court to have been taken by Finley, Kumble constitutes an actionable wrong.

A. There Is No Tort of "Conspiracy"

There is no independent tort of "conspiracy" under New York law, Health Delivery Sys., Inc. v. Scheinman, 42 App. Div.2d 566, 344 N.Y.S.2d 190 (2d Dep't 1973). In order to impose liability, one must show the commission of underlying acts recognized in law as tortious; the allegation of "conspiracy" adds nothing. Cuker Indus., Inc. v. William Crow Constr. Co., 6 App. Div.2d 415, 417, 178 N.Y.S.2d 777, 779 (1st Dep't 1958) (per curiam); Cacchione v. Westchester Country Club, 27 Misc.2d 757, 761, 209 N.Y.S.2d 52, 56 (Sup. Ct. N.Y. Co. 1960), aff'd mem., 16 App. Div. 2d 911, 230 N.Y.S.2d 665 (1st Dep't 1962).

This principle was recently reaffirmed in ATI, Inc. v. Ruder & Finn, Inc., N.Y.L.J., July 23, 1976, at 5 col. 1 (Sup. Ct. N.Y. Co., July 20, 1976), aff'd, No. 3730-1 (1st Dep't, filed Dec. 16, 1976), where the Court dismissed a complaint which purported to allege a conspiracy to injure plaintiff. The Supreme Court stated that there "is no substantive tort of conspiracy in New York" and that the complaint failed sufficiently to allege any underlying tortious act. Id. at p. 5 col. 1.

The District Court did not cite any authority contrary to these cases. The law on this point is completely clear. Judge Owen's holding that Finley, Kumble engaged in the tort of "conspiracy" against the Gross faction is clearly erroneous and should be reversed.

B. Finley, Kumble's Specific Actions Were Not Tortious

Since there is no tort of "conspiracy", the District Court could not impose liability upon Finley, Kumble unless it

found that Finley, Kumble had committed an underlying tortious act. But the District Court did not find that Finley, Kumble committed any independent tort. And, indeed, the specific actions upon which the Court relied were not tortious.

The District Court cited the following principal actions in support of its finding of liability against Finley, Kumble:

(1) enforcing, for the benefit of the Partnership, a non-competition clause in the Partnership Agreement to prevent Gross from obtaining a job at Rafkind & Co. (521);

(2) "threatening" litigation by the Partnership against the Gross faction and "threatening" to enforce, on behalf of the Partnership, the non-competition clause in the Partnership Agreement (525-27);

(3) bringing "baseless" litigations by various persons against the Gross faction: specifically, commencing this action based on the settlement and assignment of the Buckleys' churning claims; bringing the Kayne and Sloane action in California; and asserting counterclaims herein based on the "Ned Frank list" of malfeasances (526-27);

(4) the "conversion" by the Partnership of certain warrants and rights given to Gross and the other general partners as an "in-kind" distribution (517-18); and

(5) rendering the legal opinion that the Transfer Agreement was valid without the consents of Bleich and Donoghue (523-24).

The District Court also mentioned the Partnership's obtaining consent to the reorganization by certain general partners

by "forgiveness" of the partners' capital arrears (517) and its obtaining capital for the newly formed Corporation in the form of a $1 million loan from Alex Aixala (517).*

None of these actions is a proper basis for liability against Finley, Kumble. First, the enforcement of the non-competition clause was expressly held by the District Court to be completely lawful. Second, the "threats" of litigation and the "threatened" enforcement of the non-competition clause were found by the District Court to have been completely unsuccessful and thus were not actionable. Third, the commencement of the litigations, which the District Court did not find to be malicious prosecution or abuse of process, were clearly not actionable. Fourth, there was no evidence linking Finley, Kumble to the alleged "conversion" of Gross's securities. Fifth, the opinion letter was given in good faith, was not relied upon by the Gross faction, and did not cause the Gross faction any damage. Sixth, the "forgiveness" of indebtedness of certain general partners was simply "part of the transaction," as a member of the Rosenman firm testified (A2191);

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* In a passing reference in the damages section of its opinion, the District Court described the damages to the Gross faction as resulting from the "conversion" of their capital in the Partnership (529). The only specific actions cited by the District Court in support of its "conversion" theory are the non-tortious actions listed on pages 32 and 33 of this Brief. None of these actions amounts to "conversion". In any event, the Gross faction was not entitled to bring an action for "conversion". Its exclusive remedy was an action for an accounting. See Point IV(c), *infra*.

certainly, Finley, Kumble cannot be held responsible for an element of the transaction negotiated by the deficit general partners and their counsel. Finally, there is no legal theory upon which the obtaining of the Aixala loan could be actionable and the District Court did not cite any such theory.

We will discuss the principal actions relied on by the Court in its decision in more detail below.

(1) Gross's Employment Opportunity

The District Court suggested that one element of the allegedly unlawful "conspiracy" was the Partnership's assertion of a non-competition clause to prevent Gross from obtaining employment at Rafkind & Co. (521). This holding was completely unfounded. Gross had asserted this claim as his Eighth and Ninth Counterclaims, contending that the assertion of the non-competition clause was unlawful.

After hearing the evidence on this claim, Judge Owen dismissed it, finding that it was completely lawful for the Partnership to invoke the non-competition clause against Gross. Nevertheless, the Court inexplicably and erroneously found that this innocent behavior was part of an unlawful "conspiracy." It is clear that a concededly lawful act cannot become actionable merely by stating that such act was part of a civil "conspiracy."*

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* There was no evidence linking Finley, Kumble to this incident. The principal evidence relating to this claim was a letter from Lawrence Berkowitz to Rafkind & Co. dated January 26, 1971 (E853) informing Rafkind that Gross was subject to the non-competition clause. Nevertheless, the District Court dismissed the entire "conspiracy" claim as against Berkowitz (521), while holding Finley, Kumble liable.

(2) The "Threats"

The District Court found that various members of the "new team" and Persky had "threatened" the Gross faction with litigation and, as to Gross, had "threatened" the assertion of the non-competition clause (525-26). These "threats" were allegedly made during the negotiations surrounding the reorganization, when Gross himself threatened to block the transaction if he were not given special treatment in the deal. The District Court considered these "threats" to be a critical element, if not the *sine qua non*, of the alleged "conspiracy." Indeed, when Judge Owen concluded that counterclaim defendant Berkowitz "does not appear to have participated in any threats to Gross with the others of the new team", he dismissed the counterclaims as they related to him (521).

Stating that one intends to pursue his legal remedies, for example, by going to Court, can never constitute duress. *Stayton Realty Corp.* v. *Rhodes*, 200 App. Div. 108, 192 N.Y.S. 683 (1st Dep't), *aff'd*, 234 N.Y. 515 (1922). *See Bluestone* v. *Jones*, 233 N.Y.S. 2d 146, 149 (Sup. Ct. Kings Co. 1962); *Steward* v. *World-Wide Automobile Corp.*, 20 Misc.2d 188, 189 N.Y.S.2d 540 (Sup. Ct. Queens Co. 1959). Here, the District Court merely found that Finley, Kumble and its clients had told the Gross faction that they would pursue their claims in Court

if their dispute was not settled. The Gross faction made similar assertions. The New York courts have not held that such conduct is actionable.

However, even if the counterclaim defendants had threatened unlawful conduct, such threats would not have constituted an actionable wrong, since, as the District Court found, they were "all to no avail" (523). Threats, even of unlawful conduct, which are designed to force a person to do that which he otherwise would not do never constitute an actionable wrong unless they succeed in their objective. The gist of the tort of duress is "a threat of unlawful conduct intended to prevent and which does prevent another from exercising free will and restraint. . . ." Pearson v. Pearson, 29 Misc.2d 677, 212 N.Y.S.2d 281 (Sup. Ct. Kings Co.) (emphasis added), modified, 15 App. Div. 2d 554, 222 N.Y.S.2d 862 (2d Dep't 1961). See Restatement (Second) of Torts § 871(f) (Tent. Draft. No. 22, Apr. 5, 1976).

In ATI, Inc. v. Ruder & Finn, Inc., supra, N.Y.L.J., July 23, 1976, at 5 col. 1, the Supreme Court dismissed plaintiff's complaint which attempted to allege, inter alia, the tort of duress. With respect to the allegation of duress, the Supreme Court stated:

> "Two key elements of this tort are wholly absent from the complaint. There are no allegations that the defendants threatened to do anything unlawful, or that the defendants prevented plaintiff from exercising its free will." Id. at 5 col. 2.

No one disputes the fact that the reorganization was effected without the consent of the Gross faction. Any "threats" made with the intent of coercing them to go along with the transfer were a complete failure and are thus not actionable. The District Court's holding to the contrary was a clear error of law.

(3) The Litigations

The District Court listed the commencement of three litigations, which it termed "baseless", as further wrongful acts in the "conspiracy." The litigations were: (a) this action, (b) the action instituted against Gross in California by Fred Kayne and Charles Sloane and (c) the assertion of counterclaims herein by the Corporation against Gross based on the "Ned Frank list." Finley, Kumble acted as counsel to the Corporation in bringing this action and in asserting the counterclaims herein. It had nothing to do with the California action.

The commencement of litigation by the Corporation and by Messrs. Kayne and Sloane was not actionable. The only relevant torts are malicious prosecution and abuse of process. The District Court did not find that either of these torts had been committed. Nor could it, since the elements of the torts were not present. Regardless of the motives with which these claims were commenced or asserted, none of these actions constitutes malicious prosecution or abuse of process.

The New York courts consistently have held that in order for a civil proceeding to be the basis for a claim of malicious prosecution or abuse of process, the proceeding must have caused some special interference with the defendant's person or property, such as by arrest, attachment or injunction. See, e.g., Williams v. Williams, 23 N.Y.2d 592, 596, 298 N.Y.S.2d 473, 476-77 (1969); Metromedia, Inc. v. Mandel, 21 App. Div.2d 219, 223, 249 N.Y.S.2d 806, 810 (1st Dep't), aff'd, 15 N.Y.2d 616, 255 N.Y.S.2d 660 (1964); Chappelle v. Gross, 26 App. Div.2d 340, 341, 274 N.Y.S.2d 555, 557 (1st Dep't 1966); Burt v. Smith, 181 N.Y. 1, 5 (1905), appeal dismissed, 203 U.S. 129 (1906). Even a groundless, ill-motivated civil suit will not provide a basis for a malicious prosecution cause of action in the absence of interference with defendant's person or property. Sattalich v. Liben, 17 Misc. 2d 149, 183 N.Y.S.2d 924 (App. T. 1st Dep't 1959) (per curiam). Thus, a civil action for money damages cannot provide the basis for the tort of malicious prosecution.

The District Court did not find that there was any judicial interference with the Gross faction's person or property as a result of these litigations. There was no arrest, no attachment, no injunction, nor any other provisional remedy sought or granted. Thus, the Court's imposition of liability upon Finley, Kumble and the other counterclaim defendants for commencement of these actions was clearly erroneous. For this reason alone, the commencement of the litigations was not actionable.

These actions were not tortious for another reason as well. An additional essential element of malicious prosecution is that the prior proceeding must have been instituted without probable cause. As the New York Court of Appeals has stated: "[A] man may institute a well-founded prosecution with the worst of motives and the prosecution will not be deemed malicious." Munoz v. City of New York, 18 N.Y.2d 6, 9, 271 N.Y.S.2d 645, 648-49 (1966).*

The proof at trial clearly showed that there was probable cause with respect to the claims asserted by the Corporation, in which Finley, Kumble acted as counsel.

As to the Corporation's action against the Gross faction for churning, the Court itself found that there was "excessive" trading in the Buckleys' accounts (513) and abundant evidence supported that conclusion. About eight out of every ten transactions were suggested by Robert Jordan, the "customer's man" at Gross & Co. who handled the accounts (A169).** David

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* As the word "prosecution" indicates, the basis for this tort is usually a criminal proceeding. Here, of course, no criminal proceeding was instituted.

** The District Court made much of the fact that the complaint alleged that Charles Gross, rather than Jordan, was the customer's man who handled the Buckley accounts (520). This error had no legal significance, since Gross was a general partner in Gross & Co. and would be liable for the churning of any accounts of Gross & Co., regardless of the identity of the customer's man.

The District Court also criticized the fact that the complaint claimed damages of $250,000 when the Buckleys' churning counterclaim in the arbitration proceeding had claimed damages of only $75,000. The Court stated that this inflation of the churning claim was justified by "a barely

(Footnote continued on page 40)

Marcus, a securities law expert who analyzed the Buckley transactions in depth, testified that the "turnover ratios" in the Buckleys' accounts (the aggregate purchases in the accounts over a period of time divided by the average value in the accounts) were excessive (A561); that frequently purchases and sales of securities were effected within a short time period "at little or no profit to the client" (A560); and that, in his opinion, the accounts were churned (A584-590).

The District Court ultimately concluded that, despite the excessive trading, the Buckleys had consented to it and thus, that the Gross faction was not liable for churning (513-14). However, the mere fact that this claim did not succeed does not mean that it was brought without probable cause. Indeed, Judge Ward refused to dismiss the claim on Gross's pretrial motion

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(Footnote continued)

arguable legal theory" (520). Certainly attorneys must be given some leeway in setting forth the _ad damnum_ clause in a complaint, and if the extent of claimed damages can be justified on some theory -- even if, in the Court's view, that theory is "barely arguable", there can be no impropriety charged to the attorney. Hyperbole in the _ad damnum_ clause is a commonplace which, while perhaps unfortunate, has never been held to be tortious.

Moreover, the request for damages of $250,000 was clearly reasonable. The Buckleys' counterclaim for damages of $75,000 was only for commissions allegedly received as a result of the churning. In addition to commissions, the Buckleys' counterclaim had alleged that the heavy trading in their accounts resulted in net losses in the accounts of $174,049 (E110-113). In drafting the complaint in this action, Finley, Kumble properly relied on case law which indicates that damages for churning are not limited to commissions, but also include other losses proximately caused by the churning. _See, e.g._, _Stevens_ v. _Abbott, Proctor & Paine_, 288 F. Supp. 836, 850-51 (E.D.Va. 1968).

for summary judgment because he found that the claim presented a triable issue of fact (365 F.Supp. at 1371).

Moreover, this was not a claim that was initiated by Finley, Kumble or the promoters of the new Corporation. The Buckleys, represented by distinguished independent counsel, the Webster, Sheffield firm, had asserted this claim long before the proposed reorganization and long before Finley, Kumble's retention by the Partnership (A371-416).

One additional point bears mentioning concerning the churning claim. The District Court criticized Finley, Kumble for having settled the Partnership's claim against the Buckleys and obtaining an assignment of the Buckleys' churning claim against the Gross faction. The District Court even suggested that such settlement was part of the "conspiracy" (519). However, the moving force behind the settlement was not Finley, Kumble, but Lawrence Berkowitz, the Partnership's house counsel (A900-902). Nevertheless, the District Court dismissed the action as to Berkowitz (521); clearly, therefore, Finley, Kumble, which merely acted as the Partnership's counsel in settling this claim, cannot be held liable for it.

There was also probable cause with respect to the "reply counterclaims" asserted by the Corporation against Gross. The District Court stressed that there was no evidence introduced as to four of the counterclaims. However, the Corporation was not able to prove many of these counterclaims because Ned Frank, the partner with the most knowledge concerning them

and a practicing attorney, had died prior to the trial.* Thus, four of the six counterclaims had to be abandoned at trial (A1006-1014; A4466-68).

As to the remaining counterclaims, sufficient proof was presented to mandate a finding that there was probable cause to assert them. One of these remaining counterclaims alleged that Gross had had an unauthorized trading account for which he used Partnership funds and secretly traded to the damage of the Partnership. The Court found that Gross did in fact have a trading account (528). However, there was conflicting evidence as to whether the account was authorized (A4077-78; A4543-44; A4540). While there was evidence that a number of partners were unaware of the account (A4077-79), the District Court concluded that Gross's trading was known to the Executive Committee of the Partnership and was therefore authorized (528).

The other counterclaim as to which proof was presented charged that during the "back office crunch" faced by brokerage firms in 1970, Gross, as managing partner, knowingly caused the Partnership to submit false responses to certain Special Operating Questionnaires of the New York Stock Exchange (528). The evidence at trial showed, and the District Court expressly found, that "erroneous answers were . . . filed over the signature of Gross and another partner and the Partnership

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* On Gross's pre-trial motion for summary judgement, Mr. Frank had submitted a detailed affidavit outlining the factual bases for them (163).

was fined $50,000 therefor" (528). However, the District Court concluded that Gross had no personal awareness of the errors and, therefore, could not be held personally responsible (528-29).

In short, there clearly was "probable cause" with respect to the Corporation's reply counterclaims.

Just as the litigations complained of do not constitute the tort of malicious prosecution, they do not meet the requirements of the tort of abuse of process. The major distinction between malicious prosecution and abuse of process is that the latter involves the improper use of process after it is issued, while the former involves improperly causing process to issue. However, as with malicious prosecution, there can be no finding of abuse of process in the absence of some special interference with one's person or property:

> "'The gist of the action for abuse of process lies in the improper use of process after it is issued. . . .' Process is a 'direction or demand that the person to whom it is directed shall perform or refrain from the doing of some described act. . . .' It follows that there must be an unlawful interference with one's person or property under color of process in order that action for abuse of process may lie." Williams v. Williams, supra, 23 N.Y.2d at 596, 298 N.Y.S.2d at 476-77 (citations and footnotes omitted).

See Assets Collecting Co. v. Myers, 167 App. Div. 133, 152 N.Y.S. 930 (1st Dep't 1915).

(4) The "Conversion" of Gross's "In-Kind" Securities

Another act mentioned by the District Court as part of the alleged "conspiracy" was the "conversion" of certain

securities owned by Gross (517-18). However, the District Court never found that Finley, Kumble was involved in any such conversion, and there is no support in the record for such a finding. The undisputed facts are simple:

In August, 1970, the Executive Committee of the Partnership determined that each general partner owned an interest in certain warrants to purchase stock in Geon Industries, Inc. and Computer Software Systems, Inc. which had been acquired by the Partnership and held in the Partnership name. Each partner's interest was equivalent to his share of Partnership profits or losses as defined in the Articles of Limited Partnership as of January 1, 1969 (E848).

The District Court found that these securities had been converted "by the simple act of seizure of the certificates themselves" by members of the "new team" (518). While there is reason to quarrel with this conclusion,* it is undisputed that Finley, Kumble was not a member of the "new team" as the Court itself used that term. Thus, the Court's own finding does not support liability as to Finley, Kumble on this issue.

Nor could there be such a finding. The sole mention of Finley, Kumble in connection with this episode occurred in relation to a letter, dated December 30, 1970, from Kayne to Risher in which Kayne stated that there had been a Partnership vote

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* The evidence showed that the securities were at all relevant times held in the Partnership's name, never touched by a third person, and transferred to the Corporation at the closing along with all of the Partnership's other assets (A2969; A2974).

to distribute the warrants to certain parties and suggested that "[Risher] get [his] hands on these warrants and have them held in the vault at one of our banks." There was no mention of Finley, Kumble in the body of the letter. The only proof linking Finley, Kumble to this letter was the indication that Robert Persky had been sent a carbon copy (E848; 532-33).

The sole evidence on the "conversion" issue at trial, other than the letter itself, was that Risher had ignored the letter, and that any warrants held in the Partnership name were transferred to the Corporation, along with all of the other Partnership assets, at the closing on February 11, 1971 (A2969; A2974).

Even if Risher had not ignored the letter and there had been a "seizure of the certificates themselves, and their sequestration in the hands of the new team" (518), there was absolutely no evidence linking Persky or anyone at Finley, Kumble to such seizure. All Persky did was receive a copy of a letter from one party to another making a suggestion that certain securities should be obtained and held in a secure place. There was no evidence that Persky took any steps whatever with respect to this matter. The mere receipt of a letter, with no action, or the mere knowledge of possible action by others, clearly does not amount to a tort.

(5) The Opinion Letter

The final element of the alleged conspiracy cited by the District Court was Finley, Kumble's preparation of an opinion letter at the closing as "special counsel" to the Partnership. The opinion letter concluded that the Partnership "has the power and authority to enter the Agreement and consummate the transactions contemplated thereunder" (E135-36). Even if the opinion letter were incorrect, it could not provide a basis for holding Finley, Kumble liable to the Gross faction since (a) it was a reasonable interpretation of the law, (b) the circumstances pursuant to which it was written were fully disclosed and (c) it was rendered solely for the benefit of Finley, Kumble's own client, the Corporation, not for the benefit of the Gross faction.

The circumstances surrounding the submission of the opinion letter, and the reasoning contained therein, demonstrate that it was a reasonable interpretation of the law.

When Paul Burak of the Rosenman firm informed Finley, Kumble that his firm was having a "problem" with the opinion letter, Michael Bamberger, a Finley, Kumble partner, asked an associate to research the issue of whether § 98 of the New York Partnership Law would be violated if the Transfer Agreement were executed without the consent of all limited partners (A3890-91).

The research revealed that, under certain circumstances, the literal requirements of § 98 may be disregarded (A3891-92).

Thus, for example, in Mist Properties, Inc. v. Fitzsimmons Realty Co., Inc., 228 N.Y.S.2d 406 (Sup. Ct. Kings Co. 1962), the Court held that § 98 did not bar general partners from conveying partnership property where their action was consistent with the Limited Partnership Agreement. See Riviera Congress Associates v. Yassky, 25 App. Div. 2d 291, 268 N.Y.S.2d 854 (1st Dep't), aff'd, 18 N.Y.2d 540, 277 N.Y.S.2d 386 (1966).

The opinion letter extrapolated on this concept that § 98 is not always mandatory and argued that it could be overridden in special circumstances. Section 98 provides in pertinent part that,

> "without the written consent or ratification of the specific act by all the limited partners, a general partner or all of the general partners have no authority to . . . (b) Do any act which would make it impossible to carry on the ordinary business of the partnership." N.Y. Partnership Law § 98(b) (McKinney 1948) (emphasis added).

When the transfer was being considered, the Partnership was under the continual threat of suspension by the New York Stock Exchange. Suspension would have resulted in the firm's demise; the reorganization was its only hope. Thus, if the Transfer Agreement had not been executed, it would have been "impossible to carry on the ordinary business of the [P]artnership." Under these circumstances, it was, as a matter of law, reasonable to argue and conclude, as Persky did, that § 98 would not have been violated by execution of the Transfer Agreement.

Another factor demonstrating that the opinion was reasonable was the fact that between 15 and 20 distinguished counsel were present at the closing and permitted Finley, Kumble to render it (A738; A4295).

Even if the opinion letter were incorrect and had been rendered negligently, it would not provide a basis for holding Finley, Kumble liable to the Gross faction for the execution of the Transfer Agreement. As one Court has stated in dismissing a third party's claim against an attorney:

> "A want of reasonable care and skill in the performance of the attorney's duties to his client fails to constitute a basis for liability to the third party. . . ." Jacobsen v. Overseas Tankship Corp., 11 F.R.D. 97, 102 (E.D.N.Y. 1950).

Similarly, in refusing to find an attorney liable to his client, for malpractice, in giving an erroneous interpretation of a statute, the California Supreme Court noted that:

> "[t]he attorney is not liable for every mistake he may make in his practice; he is not, in the absence of an express agreement, an insurer of the soundness of his opinions or of the validity of an instrument he is engaged to draft; and he is not liable for being in error as to a question of law on which reasonable doubt may be entertained by well-informed lawyers . . . . These principles are equally applicable whether the plaintiff's claim is based on tort or breach of contract." Lucas v. Hamm, 56 Cal.2d 583, 591-92, 364 P.2d 685, 689, 15 Cal. Rptr. 821, 825 (1961).

The substance of the opinion letter further negates any finding of unreasonableness or tortious conduct. The

opinion set forth all of the relevant facts and clearly acknowledged that the language of § 98 could be read to reach a different conclusion:

> "Under all of the circumstances, notwithstanding the provisions of Section 98 of the Partnership Law, we are of the opinion that Newburger, Loeb & Co., has the power and authority to enter into the Agreement and consummate the transactions contemplated thereunder." (E135-36) (emphasis added).

Even if Persky had acted improperly, and the facts, we submit, do not support such a finding, the opinion letter does not provide a basis for holding Finley, Kumble liable to the Gross faction. The opinion letter was given for the benefit of the Corporation -- Finley, Kumble's own client -- not the Gross faction.

Under the terms of the Transfer Agreement, the opinion letter was a condition precedent of the Corporation's obligations at the closing -- it had nothing to do with the Gross faction (E38; E43-44). Thus, assuming *arguendo* that the giving of the opinion was improper, the only party having the legal right to complain would be the Corporation. Since the opinion could have been waived by the Corporation, and was not a condition precedent to any other party's obligation to execute the Transfer Agreement, it was not a material document to the actual transfer. The reorganization could have been consummated and the Partnership's property transferred to the Corporation even if it had never been prepared.

An attorney may be liable for knowingly or recklessly giving a false opinion only when both reliance and causation are established. See Wille v. Maier, 256 N.Y. 465, 472 (1931). Neither of these requisites was present here.

Convincing proof of reliance and causation must be presented to establish any claim based on a false representation:

> "A false representation does not, without more, give rise to a cause of action, either at law or in equity, in favor of the person to whom it is addressed. To give rise, under any circumstances, to a cause of action, either in law or equity, reliance on the false representation must result in injury." Sager v. Friedman, 270 N.Y. 472, 479 (1936).

Thus, where a claim is based on an allegedly false or incorrect legal opinion, reasonable reliance on the opinion must be established. National Conversion Corp. v. Cedar Bldg. Corp., 23 N.Y.2d 621, 628-629, 298 N.Y.S.2d 499, 504-05 (1969).

Reliance to his detriment must be established by a third party seeking to impose liability for a fraudulent misrepresentation. Peerless Mills Inc. v. American Tel. & Tel., 527 F.2d 445, 450 & n.2 (2d Cir. 1975) (affirming the dismissal of plaintiff's claims where the misrepresentation was not relied upon by plaintiff and was not intended to be conveyed to plaintiff):

> "A third party can recover damages for a fraudulent misrepresentation if he can establish that he relied upon it to his detriment, and that the defendants intended the misrepresentation to be conveyed to him." Id. at 450.

The elements of a third party's action for fraud involving a false representation were succinctly outlined in a recent case holding accountants liable to third parties:

> "To recover for fraud, plaintiffs must prove that (1) [Defendant] made a false representation of a material fact, (2) [Defendant] knew it was false, (3) [Defendant] made the representation with intent to deceive [persons in plaintiffs' position] and to induce them to rely upon it, (4) plaintiffs did rely upon it, and (5) plaintiffs suffered damage as a result." Herzfeld v. Laventhol, Krekstein, Horwath & Horwath, 378 F. Supp. 112, 131 (S.D.N.Y. 1974), aff'd on other grounds, 540 F.2d 27, 34 (2d Cir. 1976).

In addition, plaintiffs must also prove that their reliance was justifiable. Jones Memorial Trust v. TSAI Inv. Serv., Inc., 367 F. Supp. 491, 499-500 (S.D.N.Y. 1973); see Leasco Corp. v. Taussig, 473 F.2d 777, 782-83 (2d Cir. 1972).

The Gross faction presented no evidence of reliance or causation. None of the Gross faction ever relied on, or even acted consistently with, any act or statement of anyone associated with Finley, Kumble, and certainly none of them could be said to have relied on the opinion letter in question.

In addition to reliance, the Gross faction would also have to show that the allegedly false opinion caused some damage to them. Any evidence of such causation is conspicuously absent from this case. The opinion letter was a condition precedent of the Corporation's duty to execute the Transfer Agreement; it did not affect any other party's obligations. The Corporation had the express right to waive the opinion, and no other party

had the right to complain if such opinion were not given. Thus, the opinion letter was not a material document to the transfer, and if wrong and fraudulently given, the sole party having the right to complain would be the Corporation.

C. Gross Did Not Have Standing

The thrust of the Gross faction's contentions is that the counterclaim defendants, by means of various tortious actions, forced through the reorganization of Newburger, Loeb over the Gross faction's objections. Regardless of whether the specific actions mentioned in the District Court's opinion were tortious, Charles Gross himself has no standing to assert them because it is undisputed that, as a withdrawn general partner, Gross had no legal right to interfere with the Partnership's decision to go forward with the reorganization (E437). Section 98, by its very terms, creates no duty toward withdrawn general partners, and, as was stated by the Court in Greater Iowa Corp. v. McLendon, 378 F.2d 783, 790 (8th Cir. 1967):

> "[A] breach of statutory duty does not give rise to a private cause of action to every person injured by the statutory breach. The law clearly demands that the statutory breach must cause injury to one of the class that the statute is designed to protect. Taussig v. Wellington Fund, Inc., 313 F.2d 472, 476 (3d Cir. 1963), cert. denied 374 U.S. 806, 83 S. Ct. 1693, 10 L.Ed.2d 1031; Restatement [Second] of Torts, § 286 and § 288, [(1965)]; Prosser on Torts, pp. 154-156 (2nd Ed. 1955) (Emphasis added).

Gross was not "one of the class" that § 98 was designed to protect.

III

FINLEY, KUMBLE IS NOT LIABLE FOR THE ACTIONS OF ITS CLIENTS

As set forth in Point II, the District Court's holding that Finley, Kumble and the other counterclaim defendants had engaged in an actionable conspiracy to injure the Gross faction is unfounded, as a matter of law. However, whether or not there is a basis for holding that Finley, Kumble's clients had committed actionable torts, Finley, Kumble itself is not liable, since it acted strictly as counsel and had no "personal interest" in its clients' transactions.

Every act cited by the District Court in support of its holding against Finley, Kumble was one of the functions traditionally performed by lawyers. Finley, Kumble gave advice, rendered written opinions, handled lawsuits, negotiated settlements and drafted legal documents. It did not act as a principal or in any way go beyond the traditional lawyer's role.

The District Court's decision to impose liability upon Finley, Kumble for performing these acts, on the ground that they injured the Gross faction, is unprecedented. Indeed, the District Court did not cite a single case in support of its opinion. Nor could it, for the law is clear that an attorney cannot be held liable for the acts of his client unless it is shown that the attorney "did something either tortious in character or beyond the scope of his

honorable employment." Dallas v. Fassnacht, 42 N.Y.S.2d 415, 418 (Sup. Ct. N.Y. Co. 1943). Accord, Sefi Fabricators, Inc. v. Tillim, 79 Misc. 2d 213, 214, 360 N.Y.S.2d 146, 147 (App. T. 9th-10th Dist. 1973) (per curiam).

The well established rule is that an attorney is privileged to act on behalf of his client without fear of liability to a third party. E.g., Savings Bank v. Ward, 100 U.S. 195, 200 (1879). This principle was best articulated by Justice Silverman in D. & C. Textile Corp. v. Rudin, 41 Misc.2d 916, 918-19, 246 N.Y.S.2d 813, 816-17 (Sup. Ct. N.Y. Co. 1964). In that action, the complaint alleged that defendant attorneys conspired with other defendants to defraud plaintiff concerning its rights under a contract. In granting the defendant attorneys' motion for summary judgment, the Court stated:

> "There is no suggestion that these attorneys had any personal interest in the contracts or transactions. Interpreting the affidavits most favorably to plaintiff, the affidavits indicate that these attorney defendants knew of the contract between plaintiff and Economy Bias; that they advised their respective clients that the transactions in the form ultimately consummated would not subject them to liability under the contract and would avoid (or terminate) obligations thereunder (or alternatively they advised their clients of the legal risks involved); that perhaps they devised the transaction and certainly that they drew the appropriate documents and supervised the legal steps in the consummation.
>
> "Defendant attorneys may have been right or wrong in their advice to their clients. If they were right, that would presumably be the end of the matter, for

> surely attorneys have a right to give their clients correct legal advice. If, on the other hand, the attorneys were wrong in their advice to their clients, this may mean that their clients are liable to plaintiff. But it does not follow that the attorneys are liable. Even if we assume that the attorneys' conduct if performed by others might constitute inducement to breach of contract, the fact that the attorneys were practicing their profession itself confers a privilege which immunizes them from liability at least on the facts of this case. Thus, the Restatement of Torts states:
>
> "§ 772. PRIVILEGES TO ADVISE.
>
> "One is privileged purposely to cause another not to perform a contract, or enter into or continue a business relation, with a third person by giving honest advice to the other within the scope of a request for advice made by him * * *.
>
> "Comment:
>
> "a. Basis of the privilege. This privilege is given to protect the public and private interests in freedom of communication and friendly intercourse. In some instances the privilege protects the public and private interests in certain professions or businesses. Thus, the lawyer, the doctor, the banker, the investment counselor, and the efficiency expert need this privilege for the performance of their tasks." (See, also, Prosser on Torts, 2d ed., § 106, p. 737.)

Justice Silverman noted that this rule was backed by a strong public policy:

> "Public policy requires that attorneys - acting strictly in their professional capacities as agents and not as principals - shall be free to advise their clients without fear that the attorneys will be personally liable to third persons if the advice the attorneys have given to their clients later proves erroneous. As stated long ago by the Court of Appeals in Ford v. Williams,

> (13 N.Y. 577, 584 [1856]): 'But where one acts only in the execution of the duties of his calling or profession, and does not go beyond it, and does not actually participate in the trespass he is not liable, though what he does may aid another party in its commission.'"

Justice Silverman's observations apply with equal force to the case at bar. Finley, Kumble did not have a "personal interest" in the Transfer Agreement or the reorganization; it merely "advised [its] clients" concerning the transactions, "drew the appropriate documents" and "supervised the legal steps in the consummation." Like the attorneys in the D&C case, Finley, Kumble was merely acting in its "professional capacity" and thus is protected from liability.

Although the District Court did not cite the D&C case, it implicitly recognized the need to show that Finley, Kumble had some "personal interest in the . . . transactions," and it strained to find such an interest. Yet, the "interest" which it identified, that of obtaining fees and a lucrative new client (532), is not the type of "personal interest" which would deprive Finley, Kumble of its immunity as counsel. Every lawyer has an interest in being compensated for his services and in retaining a good client. If this type of "interest" deprived a lawyer of immunity and subjected him to liability for all of the transactions entered into by his client, the rule set forth by Justice Silverman would be meaningless.

Finley, Kumble's role as counsel clearly protected it from any potential liability with respect to the specific

actions found by the District Court to be part of the alleged "conspiracy": (1) enforcing the non-competition clause; (2) the "threats"; (3) the litigations; (4) the "conversion" of Gross's securities; and (5) rendering the opinion letter. In all of these actions Finley, Kumble was acting solely in a professional capacity.

The enforcement of the non-competition clause, which was found by the District Court to be completely lawful, obviously requires no further discussion.

The "litigations" and "threats" can be dealt with together. Even if the commencement of the litigations by the Corporation was tortious, Finley, Kumble, which was not a party to the litigations, but merely acted as counsel, could not be held liable for them. The mere bringing of an action by an attorney for his client can not be the basis for holding the attorney liable to a third party unless the attorney has a "personal interest" in the action. *See*, *e.g.*, *Dallas* v. *Fassnacht*, 42 N.Y.S.2d 415 (Sup. Ct. N.Y. Co. 1943); *Solomon* v. *Baar*, 168 Misc. 439, 5 N.Y.S.2d 753 (Sup. Ct. N.Y. Co.), *aff'd* *mem.*, 255 App. Div. 849, 7 N.Y.S.2d 1022 (1st Dep't 1938). Moreover, the wrongful acts or intentions of a client cannot be imputed to his attorney. *Sefi Fabricators, Inc.* v. *Tillim*, 79 Misc.2d 213, 360 N.Y.S.2d 146 (App. T. 9th-10th Dist. 1973) (*per curiam*); *cf*. *Vernes* v. *Phillips*, 266 N.Y. 298 (1935); *Victor* v. *Goldman*, 74 Misc.2d 685, 344 N.Y.S.2d 672 (Sup. Ct. Rockland Co. 1973). *A fortiori*, if an attorney cannot be held liable

for <u>bringing</u> litigation for a client, he surely cannot be held liable for asserting to a third party that such litigation will be brought.

As for the "conversion" incident, the only evidence concerning Finley, Kumble was that it received a copy of a letter suggesting that the securities be obtained and held in a secure place. Surely, Finley, Kumble's knowledge that a certain event might take place does not make it liable to a third party affected by the event simply because Finley, Kumble is a law firm. On the contrary, if an attorney is privileged to advise his client to take action, which if taken, could result in liability on the part of the client, <u>see</u>, <u>e.g.</u>, <u>D & C Textile Corp.</u> v. <u>Rudin</u>, 41 Misc.2d 916, 246 N.Y.S.2d 813 (Sup. Ct. N.Y. Co. 1964), he is also privileged to be advised by his client that the client intends to take -- or might take -- certain action. To hold an attorney liable solely because he received a copy of a letter directing someone else to take certain actions would place a chilling effect on the attorney-client relationship and would be at odds with the fundamental policy of open communication between attorney and client.

Finally, as discussed at length in Point II, Finley, Kumble's legal opinion in the opinion letter was a reasonable interpretation of the law, was based on factors which were fully disclosed and did not result in any damage to the Gross faction. Thus, Finley, Kumble is protected from liability for this action as well.

In sum, Finley, Kumble, which acted solely as counsel in the transactions at issue on this appeal, may not be held liable for any allegedly wrongful acts which may have been committed by its clients.

IV

THE DISTRICT COURT ERRED IN ASSESSING DAMAGES

The District Court awarded, *inter alia*, (a) punitive damages of $50,000; (b) damages of $134,171, plus interest, for the "conversion" of Gross's "in-kind" securities; and (c) damages of $337,921, plus interest, representing Gross's capital interest.

For the reasons stated in Points I, II and III, none of these awards of damages was proper against Finley, Kumble. However, whether or not there was a basis for liability against Finley, Kumble, the District Court's assessment of damages was erroneous. It improperly awarded punitive damages; it granted affirmative relief for the "conversion" of Gross's "in-kind" securities when this claim was only available as a set-off; and it erroneously determined the value of Gross's capital interest. Thus, even if this Court upholds Judge Owen's finding of liability, it should set aside the award of punitive damages and the award of damages for the "conversion" of Gross's in-kind" securities and should remand this action to the District Court for a proper determination of the value of Gross's capital interest.

A. Punitive Damages Were Improper

In awarding punitive damages against "the new team ...., Persky and Finley, Kumble," the District Court ignored the applicable New York law.* The New York courts have held uniformly that in actions for fraud, conversion and unfair appropriation of plaintiff's property, punitive damages are inappropriate unless the wrongful conduct of defendants is aimed at the public generally.

In Walker v. Sheldon, 10 N.Y.2d 401, 405, 223 N.Y.S.2d 488, 491 (1961), the Court of Appeals stated that while punitive damages have been disallowed in the "ordinary" fraud and deceit case, "there may be a recovery of exemplary damages in fraud and deceit actions where the fraud, aimed at the public generally, is gross and involves high moral culpability," or when "defendant's conduct evinced a high degree of moral turpitude and demonstrated such wanton dishonesty as to imply a criminal indifference to civil obligations." There, the plaintiff had alleged that it was induced by defendants to enter a contract and make certain payments by a fraudulent representation. In affirming a refusal to strike the allegations relating to punitive damages, the Court reasoned that:

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* Since the counterclaims in question were non-federal claims, New York law is applicable in determining whether punitive damages were appropriate. Koufakis v. Carvel, 425 F.2d 892, 905 (2d Cir. 1970).

> "The pleading charges that defrauding the general public . . . was the very basis of the defendants' business. What is aserted is not an isolated transaction incident to an otherwise legitimate business, but a gross and wanton fraud upon the public. It follows, therefore, that the courts below were thoroughly justified in refusing to strike the allegations which pertain to punitive damages." Id. at 406, 223 N.Y.S.2d at 492.

The Court noted the conclusion of the Court below that if the allegations of the complaint were true, "defendants were engaged in carrying on 'a virtually larcenous scheme to trap generally the unwary.'" Id. at 404, 223 N.Y.S.2d at 490.

In James v. Powell, 19 N.Y.2d 249, 279 N.Y.S.2d 10 (1967), the Court of Appeals held that punitive damages were not available against a defendant who had made a fraudulent conveyance of property. Citing Walker v. Sheldon, the Court noted that punitive damages would be available only where the fraud is "aimed at the public generally, is gross and involves high moral culpability." The Court also observed:

> "Furthermore, effective remedies are provided against fraudulent conveyances, including the assessment against the tort-feasors, in appropriate cases, of the costs incurred in pursuing such remedies, and there is no need to offer the prospect of punitive damages as an inducement to institute suit . . . . In short, the defendant Powell may have committed a wrongful act but his conduct was not so 'gross and wanton' as to bring it within the class of malfeasances for which punitive damages may be awarded." Id. at 260, 279 N.Y.S.2d at 18-19.

Thus, in addition to holding that defendant's actions must be "aimed at the public generally," the Court of Appeals in both Sheldon and Powell stated that an important factor in determining whether punitive damages are appropriate is whether the prospect of such damages are necessary as an inducement to institute suit, i.e., where there is no prospect of compensatory damages or other effective relief. Surely, such is not the case here.

The standards enunciated in the Sheldon and Powell cases have also been applied in actions for fraudulent conversion, wrongful appropriation of property, and unfair competition. In Vinlis Construction Co., Inc. v. Roreck, 27 N.Y.2d 687, 314 N.Y.S.2d 8 (1970), the Court of Appeals modified an order of the lower court by striking an award of exemplary damages. Plaintiffs had sued for an accounting and for damages arising from alleged conversion and fraud by a fiduciary. The lower court found that defendant, in addition to converting plaintiffs' monies, had "deliberately concealed and destroyed or ordered concealed and destroyed records of the trust estate" and that "[t]he destruction of the trust records was for the purpose of hiding defendant's illegal conduct and preventing the disclosure thereof . . ." 30 App. Div. 2d 668, 291 N.Y.S.2d 924, 926 (2d Dept. 1968). Nevertheless, the Court of Appeals ruled that plaintiffs were not entitled to

exemplary damages since the fraud was not "aimed at the public generally." 27 N.Y.2d at 689, 314 N.Y.S.2d at 9.*

It is undisputed that none of the actions by Finley, Kumble criticized by Judge Owen were aimed at the public or otherwise fit the requirements of the New York Court of Appeals for an award of punitive damages. The Gross faction did not allege an injury to the public by Finley, Kumble nor did the District Court find such an injury.

The New York courts have drawn a dichotomy between wrongful conduct related to business transactions and wrongful conduct aimed to injure a party personally, outside of the context of economically motivated transactions. While the precise nature of the Gross faction's claims here is not perfectly clear, it is nevertheless apparent that their action was essentially one for conversion and wrongful appropriation.

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* Similarly, in American Electronics, Inc. v. Neptune Meter Co., 30 App. Div. 2d 117, 290 N.Y.S.2d 333 (1st Dept. 1968), the Appellate Division ruled that it was error for the trial court to award punitive damages. In that action for unfair competition, the Court found that the record established:

> "by overwhelming proof that defendants wilfully and deliberately engaged in a conspiracy and course of conduct which violated elementary standards of morality in the business community and secured for themselves at plaintiffs' expense a public contract . . ." (Id. at 118, 290 N.Y.S.2d at 335).

Notwithstanding this finding, the Court held that "plaintiffs are not entitled to punitive damages since no public right is involved and the underlying private wrong is susceptible of adequate compensation." Id. at 119, 290 N.Y.S.2d at 335.

And, as noted above, p. 62, in such actions, punitive damages are not recoverable as a matter of law unless the wrongdoing is aimed at the public generally and unless the underlying wrong is not susceptible of adequate compensation.

This Court's decision in Koufakis v. Carvel, 425 F.2d 892 (2d Cir. 1970), we submit, is dispositive on this issue. There, this Court held that exemplary damages were not permissible on a claim alleging a fraudulent scheme to breach a franchise contract and the wrongful termination of such contract. This Court stated:

> "The most recent New York decisions indicate that the state courts should be very selective in allowing punitive damage awards; the factors considered in exercising this selectivity include the nature of the conduct, the sufficiency of an award of compensatory damages and other remedies to deter such conduct in the future, and the likelihood that an award of compensatory damages would induce the plaintiff to sue Id. at 906-07.

The Court went on to hold:

> The present dispute between the parties to a business contract, with some history of troubled relations over the years, does not measure up to the standards to be gleaned from Walker v. Sheldon and James v. Powell. See American Electronics, Inc. v. Neptune Meter Company, 30 A.D. 2d 117, 290 N.Y.S.2d 333 (1st Dept. 1968). . . . First, this case does not, as did Walker v. Sheldon, present a fraud 'aimed at the public generally.' We think it significant that the New York Court of Appeals in James v. Powell quoted that particular portion of Walker v. Sheldon, and that James v. Powell involved a dispute between only two parties.
>
> Second, we do not believe that the present case is one where the possibility of punitive damages is necessary to induce suit to right a wrong which

> otherwise would go unpunished. The breach of contract action, with the possibility of substantial compensatory damages, is sufficient to induce suit and provide deterrence." Id. at 906-08.

The District Court cited three cases in support of its award of punitive damages (535). Only one of these cases, Reynolds v. Pegler, 223 F.2d 429 (2d Cir.), cert. denied, 350 U.S. 846 (1955), was based on New York law.* The Reynolds case was decided prior to Walker v. Sheldon, James v. Powell and Koufakis v. Carvel, supra, and has been modified by this Court's more recent decision in Koufakis and by the two more recent decisions of the New York Court of Appeals.

The District Court's error in awarding punitive damages is highlighted by the inconsistency between its

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* The other two cases cited by the District Court clearly have no application here. Farawotz v. Associated Musicians, Local 802, 241 F. Supp. 895 (S.D.N.Y. 1965), was an action by a musician who had been expelled from the defendant union, for an injunction and damages under the Labor-Management Reporting and Disclosure Act of 1959, 29 U.S.C. §§ 401 et. seq. The Court granted an injunction, $1 compensatory damages and $1,000 punitive damages. In awarding punitive damages, the Court did not rely on New York law, since the wrong complained of was the violation of a federal statute. The Court expressly held that the punitive damage award was made pursuant to the Labor-Management Reporting and Disclosure Act. Id. at 909. In Mid-Continent Telephone Corp. v. Home Telephone Co., 319 F. Supp. 1176, 1200 (N.D. Miss. 1970), the District Court expressly applied Mississippi law in awarding punitive damages for tortious interference with a contract.

opinion and judgment. In his opinion, Judge Owen purported to award "punitive damages against the new team (except Berkowitz), Persky and Finley, Kumble in the sum of $50,000" (535). Judge Owen defined the new team as "the promoters and thereafter principal officers of the new Corporation," i.e. Kayne, Muh, Risher, Sloane and Berkowitz (510). The judgment, entered on September 1, 1976, inexplicably assessed punitive damages against the Corporation as well. Moreover, on November 17, 1976, the Court amended its judgment to delete Muh and Sloane from that portion of the judgment awarding punitive damages even though they were expressly part of the "new team" which the Court said was principally responsible for the damages to the Gross faction. The amending order erroneously and without explanation stated: "I did not find these people liable under that cause of action" (571).

B. <u>The "Conversion" of Gross's "In-Kind" Securities</u>

The Third Counterclaim, alleged only on behalf of Gross, sought damages for the alleged "conversion" of certain warrants to purchase stock held in the Partnership name which Gross claimed had vested in him. The District Court imposed liability for the alleged "conversion" upon four counterclaim

defendants, Kayne, Risher, Persky and Finley, Kumble (533). As noted above, pp. 44-46, there was no support in the record for such a finding as to Finley, Kumble.

However, regardless of the merits of the Conversion Counterclaim and the identity of the parties responsible for the alleged conversion, it was error for the District Court to grant any affirmative relief. Judge Ward had expressly held that there could be no such relief because there was no subject matter jurisdiction of this claim:

> "The Third [Conversion], Fifth, Sixth, Seventh and Eighth counterclaims are not logically related to the plaintiff's cause of action; therefore, they are not compulsory counterclaims. Since there is no independent basis for federal jurisdiction, these counterclaims may be maintained only to the extent that they constitute a set-off; they may not be asserted as a basis for affirmative relief (365 F. Supp. at 1367).

Judge Ward's ruling was the law of the case. In his opinion, Judge Owen quite properly purported to follow Judge Ward's ruling and reiterated that the Conversion Counterclaim was maintainable only to the extent that it constituted a set-off (514). Indeed, Judge Owen expressly stated that, since he had ruled in favor of the Gross faction on the complaint, he would not consider the merits of the non-compulsory counterclaims, including the Conversion Counterclaim (Id.).

However, ignoring the law of the case and his own expressed intention to follow it, Judge Owen proceeded to grant affirmative relief in the amount of $134,171 on the Conversion Counterclaim. Apparently recognizing the inconsistency involved in making such an award, the Court gave three reasons for its decision, all of which are unsupportable (536).

First, the Court stated that this item of damage "is arguably pleaded in paragraph 44 of the amended answer "(536). However, paragraph 44 of the amended answer, which is part of the Second Counterclaim, merely alleges that the capital interests of Gross, Bleich, and Donoghue constituted the major portion of the liquid working capital of the Corporation (42). This allegation has nothing to do with Gross's "in-kind" securities. Indeed, the amended answer clearly delineated between Gross's capital interest in the Partnership and Gross's "in-kind" securities, which were two completely different economic interests. Nowhere in the First, Second or Fourth Counterclaims is there any reference to Gross's "in-kind" securities, and nowhere in the Third Counterclaim is there any reference to Gross's capital interest in the Partnership. Indeed, in paragraph 57 of the amended answer, Gross alleged that the "in-kind" securities were his personal property and were not part of his capital interest in the Partnership (44). The District Court's conclusion that the conversion of Gross's

"in-kind" securities is alleged in paragraph 44 or anywhere else in the Second Counterclaim was baseless.

Second, the District Court said that, in any event, the issue was fully litigated (536). However, the question of whether this issue had been "fully litigated" was irrelevant, since the Court did not have subject matter jurisdiction of the claim. If there is no subject matter jurisdiction over a claim, such defect cannot be remedied by litigating it.

On the basis of these two faulty premises, the District Court held that the pleadings could be "amended to conform to the proof" (536). However, contrary to Judge Owen's holding, the Court's jurisdiction cannot be extended beyond its proper bounds by the simple expedient of amending the pleadings to conform to the proof. The question of whether the Court may grant relief to Gross on the Conversion Counterclaim is not a technical pleading matter; it concerns the Court's jurisdiction. The Third Counterclaim, in clear terms, related to the conversion of Gross's "in-kind" securities. Judge Ward, in equally clear terms, had held that this claim was "not logically related to the plaintiff's cause of action" (365 F.Supp. at 1367). Since the law of the case was that the Court did not have subject matter jurisdiction of this counterclaim, the District Court had no choice but to allow this counterclaim to be maintainable only to the extent that it constituted a set-off.

C. Gross's Capital Interest

In awarding damages to Gross for his capital interest in the Partnership, the District Court held that:

> "The amount of capital owing to Gross as of February 11, 1971 * * * depends upon what an accounting would have then shown or today shows with a fair degree of certainty was owing to him on that date" (529).

Implicit in this finding is the Court's recognition that the proper remedy for the wrong allegedly done to Gross was an accounting. Judge Ward similarly acknowledged that, "[a]t the time of the execution of the Transfer Agreement, the only interest Gross, Bleich, and Donoghue had in the Partnership was the right to be paid certain sums of money." 365 F. Supp. at 1370.

However, the District Court did not conduct a proper accounting to determine Gross's damages. Instead, it accepted the figure of $337,921 reached by one accountant, Irving Lauterbach, who testified on Gross's behalf, and ignored the financial statements and schedule of partners' capital accounts prepared by Peat, Marwick, Mitchell & Co. In an apparent effort to justify this unwarranted action, the Court stated that the Partnership, by permitting the transfer of its assets to the Corporation, had destroyed the opportunity for an accounting (531). This finding is baseless. After the transfer, and through the trial, all of the records upon which an accounting would be based remained intact and available to the Court. Indeed, Lauterbach himself utilized the books and records of the Partnership to reach his conclusions.

The District Court found that the Partnership's losses were inflated by the "members of the new team telling Peat Marwick what to put in the [financial] statement, which Peat Marwick accepted without further inquiry" (530). However, Estill Alvey, one of the Peat Marwick accountants who had prepared the financial statements for the Partnership and who testified as an expert on behalf of the counterclaim defendants, stated that it is the normal procedure for management to supply financial information to the accountants for preparation of financial statements (A4119-20). Moreover, the accountants do not accept without question figures given to them by management. Rather, they independently examine the information given to them and disagree with that information if it appears unwarranted or in some way erroneous (A4142; A4152). And he testified -- without contradiction -- that this was the procedure followed here.

Since Lauterbach's figures were based upon inconsistent theories and riddled with glaring mistakes, the District Court's finding that Gross was entitled to $337,921 was clearly erroneous and must be set aside (Fed. R. Civ. P. 52(a)). In light of these clearly erroneous findings and the District Court's failure to conduct a proper accounting, this Court must remand this case to the District Court for a determination as to the correct value of Gross's capital account.

In American Pacific Dairy Prods., Inc. v. Siciliano, 235 F.2d 74 (9th Cir. 1956), the Ninth Circuit set aside those

portions of the District Court's computation of a partner's capital account which were either inaccurate or arbitrary. *Id.* at 82-84. Additionally, the Court ruled that the District Court had erred in failing to order an accounting as to another portion of the partner's claimed interest in the partnership. *Id.* at 84.

The appropriateness of an accounting as a remedy for partners is one of the fundamental tenets of partnership law. Indeed, the courts have indicated that an accounting is the exclusive remedy for matters relating to partnership transactions and that the extent of a partner's right to money from the partnership can only be determined by an accounting, not, for example, by an action for conversion:

> "It is well settled that one partner cannot sue the other at law, as distinguished from an action in equity, with respect to partnership transactions, except after a full accounting, and balance struck, and such an action is on contract and not *ex delicto*. If one partner betrays his trust, and converts to his own use partnership property, he incurs the usual liability that one partner incurs to another respecting partnership affairs, *i.e.*, to be held liable in an accounting, but he cannot be sued by the other partner for damages in an action for conversion." *Dalury v. Rezinas*, 183 App. Div. 456, 460, 170 N.Y.S. 1045, 1049 (1st Dep't 1918), *aff'd*, 229 N.Y. 513 (1920).

In *Blattberg* v. *Weiss*, 61 Misc.2d 564, 567-68, 306 N.Y.S.2d 88, 92 (Sup. Ct. Queens Co. 1969), limited partners brought an action against general partners to recover their partnership interests which had allegedly been diminished by the

willful actions of the general partners. The Court directed judgment for defendants, stating that:

> "The rule is well settled, and has been reiterated time and time again, that neither partners nor joint venturers can sue each other at law for anything relating to the concerns of the partnership or joint enterprise until after a settlement and balance struck and express promise to pay. [Citations omitted.] In Squire v. Wing, 35 Misc.2d 287, 288, 230 N.Y.S.2d 42, aff'd. 17 A.D. 2d 835, 233 N.Y.S.2d 84 the court dismissed the complaint in an action at law saying, that 'it is still the general rule * * * that suits between partners should be brought in equity, particularly for an accounting, and that an action at law may not be maintained until after an accounting and a balance struck.'"

In the instant case, the District Court failed to conduct an accounting concerning Gross's capital account. Rather, it accepted Lauterbach's erroneous calculations and ignored the inconsistencies in those calculations. Thus, the District Court's award to Gross of $337,921 was clearly erroneous and must be set aside.

In the financial statement and schedule of partners' capital accounts prepared by Peat, Marwick, Gross's capital account was stated to be $129,561 (E951-57). Lauterbach's testimony and a schedule he prepared in support (E871-76) shows that he disagreed with the Peat Marwick schedule only in one respect. Specifically, he disagreed with the Peat Marwick statement of 1970 operating losses as applied to Gross (A2552). The thrust of Lauterbach's testimony was that the Partnership had inflated 1970 operating losses by including, in some instances, improper write-offs, and by excluding certain items which he

claimed should have been treated as assets. Gross contended at trial, based on Lauterbach's testimony, that the Partnership had inflated the 1970 operating losses in order to reduce Gross's capital interest* (Defendants' Post Trial Brief at 132).

The Peat, Marwick financial statement reported 1970 operating losses for the Partnership as $3,017,078 and had debited each general partner's capital account with his respective distributive share of such losses. In accordance with a formula pursuant to the Partnership Agreement, Gross was chargeable with 14.21892 percent of 1970 operating losses (E412-55; E871-76). There is no dispute as to this formula, and indeed, Gross expressly agreed that his distributive share of losses for the year was 14.21892 percent (E871-76; see also Defendants' Post Trial Brief at 127-28).

Lauterbach's disagreement with the computation of Gross's share of 1970 operating losses by Peat, Marwick, was set forth in Defendants' Exhibit VVVV (E871-76). That exhibit set forth fifteen items of adjustment to the Peat, Marwick

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* The flaw in Lauterbach's contention that the Partnership overstated 1970 operating losses in order to reduce Gross's capital account is shown if Lauterbach's calculations are extended to their logical conclusion. If his figures were correct, the capital account of every other general partner would similarly be increased. Indeed, if the Partnership had used Lauterbach's computation of $1,551,709 as 1970 operating losses in its financial statement, rather than the $3,017,078 statement of losses it did use, there would have been no need for a forgiveness of indebtedness of those general partners in deficit capital positions, since their deficit positions would have been reduced. Thus, the application of Lauterbach's figures to the capital position of the general partners, shows that there could not have been any motive to inflate the losses of the Partnership.

statement of the Partnership's 1970 operating losses, thereby reducing stated losses from $3,017,078 to $1,551,709, and computed Gross's share of 1970 operating losses as 14.21892 percent of this reduced figure (E871-76). Thus, Lauterbach concluded that Gross's share of operating losses was $220,636, rather than $428,996 and that Gross's capital interest was $337,921 rather than $129,561.

The District Court accepted Lauterbach's recomputation of Gross's capital interest as $337,921 despite the facts that a) many of the adjustments conflicted with defendants' and Lauterbach's own admission that Gross was chargeable with approximately 14 percent of losses occurring over the <u>entire</u> 1970 calendar year, and b) many of the adjustments contained clear errors.

The first item contained in Lauterbach's schedule referred to the Atlas Realty settlement, for which Lauterbach subtracted $411,655 from 1970 operating losses. This item represented an agreement negotiated by the Partnership in the autumn of 1970 to terminate a long-term lease of space with Atlas Realty by paying $411,655. The lease itself was for a period of 20 years at a total rent of $6,000,000 (A2746-47, A2800-01).

Gross contended that this item was improperly charged to calendar year 1970, and that the settlement of rent for future years was not part of the 1970 operating picture of the firm (Defendants' Post Trial Brief at 131-32). Yet, as the Peat Marwick accountant testified, it would have been improper for the Partnership, which was on an accrual accounting

basis, not to reflect this loss in the year of the settlement (A4152-53). Moreover, Lauterbach overlooked the undisputed fact that a substantial portion of the $411,655 settlement, $178,705, was actually paid by the Partnership in 1970 (E952). Thus, even if it were improper for the Partnership to write off the entire $411,655 for 1970, the $178,705 that was actually paid in 1970 -- a sum far less than what the annual rental under the lease would have been -- was clearly a proper part of the 1970 losses. Indeed, the failure to recognize the actual expenditure of such sum would be a distortion of the financial statement of the firm. Adding back the $411,655 to 1970 operating losses would reduce Lauterbach's computation of Gross's capital by $58,532.* Even if only that portion of the settlement which was paid in 1970 were added back to operating losses, Lauterbach's computation of Gross's capital would be reduced by $25,409.

Lauterbach's explanation for a number of other adjustments he made to the 1970 operating losses, Items 2-6 and 9, aggregating $336,630, was that the Partnership, in its unaudited monthly statements, indicated that the write-offs in question were "extraordinary" and "incurred in November [or December] 1970" (E874-76).

However, as noted above, p. 74, Lauterbach agreed that Gross's share of operating losses was to be prorated over the entire calendar year, and that his share of 1970 operating losses

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* Gross would be chargeable with 14.21892 percent of the loss.

was 14.21892 percent. Thus, to the extent that Lauterbach based his adjustments on the fact that certain write-offs or losses were incurred after Gross resigned but still in calendar year 1970, such adjustments were clearly erroneous.*

Lauterbach made other adjustments on the grounds that certain write-offs were not supported by adequate documents or were excessive, Items 7, 10, 11 and 12, aggregating $157,047. Yet, rather than subtracting only that portion of a write-off claimed to be excessive, Lauterbach subtracted the entire amount.

Lauterbach's largest adjustment, Item 15, was the reduction of the Partnership's 1970 operating losses by an amount equal to the estimated amount of the Partnership's New York State and New York City carryback tax refund claims, $494,156 (E876). Lauterbach's explanation of this adjustment was that the Peat, Marwick workpapers had calculated that the estimated amount of recoverable taxes from the state and city was $494,156, and that "[n]o asset value was ascribed to this recovery in the financial statement . . ." (E876). Instead, Peat, Marwick added a footnote to the financial statement indicating that "no effect has been given in this statement to any tax refunds which may be received as a result of a carryback of the current year's operating loss." (E955).

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* Lauterbach indicated that part of the basis for his adjustments was indeed that some of the write-offs in question pertained to events after Gross' resignation. Thus, when asked if his adjustments had anything to do with the fact that Gross withdrew prior to the end of 1970, he answered "Yes" (A2555-56). This was inconsistent with all his other testimony and, more importantly, was inconsistent with what the Partnership Agreement provided.

Lauterbach's characterization of this item as a "recovery" for which asset value should have been given is both misleading and unsupportable, since the undisputed evidence at trial was that no recovery of such refunds had yet been made. Albert Dworkin, the attorney who handled these claims, testified that the efforts to recover these tax refunds had produced no results. New York State had taken the position that it would be required to deny the claim; New York City had not yet taken any position (A3683-84). Thus, as of the summer of 1975, four years after that in which "no asset value was ascribed to this recovery" no tax refunds had in fact been recovered.

The contingent nature of these refund claims makes clear that it would have been improper to treat the entire amount of the claims as an asset. Indeed, Gross conceded that this "asset" was contingent by arguing that only <u>some</u> asset value should have been given to these claims:

> "No credit at all was given to Gross in connection with potential recovery of taxes in the amount of $494,000 although these tax claims were being actively pursued. The adversaries introduced testimony of Mr. Dworkin to the effect that he was prosecuting the claim and that he now felt recovery was unlikely but no explanation was given for the <u>total exclusion of this contingent asset</u> . . ." (Defendants' Post Trial Brief at 131) (Emphasis supplied).

Given their contingent nature, it would not have been proper to treat the entire amount of these claims as an asset in the Partnership's financial statement.

Conclusion

For the foregoing reasons, that part of the District Court's judgment which granted relief to defendants against Finley, Kumble should be reversed, and the counterclaims asserted against Finley, Kumble should be dismissed. Alternatively, we submit that the District Court's award of punitive damages and of damages on defendants' Third Counterclaim should be set aside and that this action should be remanded to the District Court for a proper accounting of the value of Gross's capital interest.

Dated: New York, New York,
February 4, 1977

Respectfully submitted,

PAUL, WEISS, RIFKIND, WHARTON & GARRISON
345 Park Avenue
New York, New York 10022
(212) 644-8000

Of Counsel:
Simon H. Rifkind
Mark H. Alcott
John M. Delehanty
Beryl A. Schatz

and

FINLEY, KUMBLE, WAGNER, HEINE & UNDERBERG
425 Park Avenue
New York, New York 10022
(212) 371-5900

Attorneys for Additional Defendant on Counterclaims-Appellant-Cross-Appellee Finley, Kumble, Wagner, Heine Underberg & Grutman

Of Counsel:
Alan M. Gelb

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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NEWBURGER, LOEB & CO., INC., as Assignee of Claims of David Buckley and Mary Buckley,

Plaintiff - Appellant - Cross-Appellee,

-against-

CHARLES GROSS, MABEL BLEICH, GROSS & CO. and JEANNE DONOGHUE,

Defendants - Appellees - Cross-Appellants,

NEWBURGER, LOEB & CO., et al.,

Additional Defendants on Counterclaims - Appellants - Cross-Appellees.

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Docket No. 76-7476

AFFIDAVIT OF SERVICE

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

RICHARD KURNIT, being duly sworn, deposes and says:

I am over twenty-one years of age, not a party to this action, and reside at 124 West 93rd Street, New York, New York.

On February 4, 1977, I served two copies of the attached Brief upon all Counsel of Record in the above matter by depositing true copies of the same in a postpaid properly addressed wrapper in an official depository under the exclusive care and custody of the United States Post Office Department within the State of New York.

Richard Kurnit
Richard Kurnit

Sworn to before me this
4th day of February, 1977

Edward H Sutton
Notary Public

EDWARD H. SUTTON
Notary Public, State of New York
No. 03-3907350
Qualified in Bronx County
Commission Expires March 30, 1977